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JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION
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REFUNDS AND CREDITS OF INTERNAL REVENUE TAXES

REPORT OF JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

Pursuant to Section 710 of the Revenue Act of 1928

AND

REPORT OF THE STAFF OF THE JOINT COMMITTEE
TO THE COMMITTEE



JUNE 19, 1929.—Referred to the Committee on Ways and Means and
ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1929

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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L. H. PARKER,
Chief Division of Investigation.
G. D. CHESTEEN, *Assistant Chief.*

LETTER OF TRANSMITTAL

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, June 19, 1929.

THE SPEAKER OF THE HOUSE OF REPRESENTATIVES.

SIR: Pursuant to section 710 of the revenue act of 1928, I have the honor to submit a report by the Joint Committee on Internal Revenue Taxation, dated June 8, 1929.

Very respectfully,

WILLIS C. HAWLEY,
Chairman Joint Committee on Internal Revenue Taxation.

(iii)

REPORT OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION ON REFUNDS AND CREDITS

(PURSUANT TO THE REVENUE ACT OF 1928)

Washington, D. C., June 8, 1929.

The revenue act of 1928 in section 710 requires that all refunds and credits in excess of \$75,000 shall be reported to the Joint Committee on Internal Revenue Taxation. This section also requires a report to be made by the committee annually of such refunds and credits, including the names of all persons or corporations to whom amounts were credited or payments made, together with the amounts credited or paid to each.

In accordance with this provision in the revenue act of 1928, the joint committee has caused its Division of Investigation to examine all refunds reported to it by the Commissioner of Internal Revenue.

A complete copy of the report submitted to the joint committee by Mr. Parker, chief of the Division of Investigation, is attached hereto. Part I of this report includes the names of all persons and corporations to whom credits or refunds have been made and shows the amounts credited or paid to each. The committee approves this list, which agrees with the records of the Treasury Department.

While it is not specifically required by law, the committee deems it wise also to submit to the Congress Parts II and III of Mr. Parker's report, which cover a general survey of the overassessments and also a study of certain individual cases. The committee does not specifically approve or disapprove of Parts II and III of this report, which is published for information purposes only.

Inasmuch as this report covers only refunds for the period from June 1 to December 31, 1928, the committee deems it wise to include also, as a supplement to this report, a report by the Division of Investigation on refunds and credits made under the urgent deficiency bill, approved on February 28, 1927. This report covers in detail the period from November 1, 1927, to April 24, 1928, and is the second report on this subject submitted to the committee in regard to refunds and credits under the urgent deficiency bill.

This supplemental report has not been specifically approved or disapproved by the committee and is also published for information purposes.

Very respectfully,

WILLIS C. HAWLEY,
Chairman Joint Committee on Internal Revenue Taxation.

LETTER OF SUBMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, February 18, 1929.

HON. WILLIS C. HAWLEY,
Chairman Joint Committee on Internal Revenue Taxation,
Washington, D. C.

MY DEAR CHAIRMAN: There is submitted herewith a report on refunds and credits submitted to the Joint Committee on Internal Revenue Taxation as provided in section 710 of the revenue act of 1928.

This report covers in detail the period June 1 to December 31, 1928. No refunds were received under the requirements of the 1928 act prior to June 1, 1928. In making a statistical analysis, however, refunds and credits reported to the joint committee under the "urgent deficiency bill" are included. This gives a 21-month period, which is more representative of general conditions than the 7-month period first noted.

In the opinion of the writer, the most important facts brought out by this report are as follows:

First. Eighty-three per cent of the total overassessments reported in a 21-month period are for taxable years prior to 1922, or in other words, are for the period during which the excess profits tax was in force. A decrease in refunds may be expected when the excess profits tax years are finally closed.

Second. Valuations, required by the various provisions, are probably the cause of more controversy than any other determinations necessary under our present revenue act.

Third. The increase in the rate of refundment during the present fiscal year appears to be due to three factors, (a) the decision of the Supreme Court in re life insurance companies, (b) the large refund to the United States Steel Corporation, and (c) the drive of the bureau to get its work current.

Fourth. The study of individual cases indicates that a review of certain regulations which are uniformly favorable to certain industries might profitably be made, since these issues may not get before the courts. This study might provide information upon which legislation could be based.

Fifth. The refunds and credits made by the commissioner are in general plainly correct and not open to serious criticism. A difference of opinion exists in relatively few cases.

Respectfully submitted.

L. H. PARKER,
Chief Division of Investigation.

REPORT ON REFUNDS AND CREDITS

FOREWORD

Section 710 of the revenue act of 1928 provides as follows in connection with refunds and credits in excess of \$75,000:

SEC. 710. REFUNDS AND CREDITS TO BE REFERRED TO JOINT COMMITTEE

No refund or credit of any income, war-profits, excess-profits, estate or gift tax, in excess of \$75,000, shall be made after the enactment of this Act, until after the expiration of thirty days from the date upon which a report giving the name of the person to whom the refund or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Commissioner of Internal Revenue is submitted to the Joint Committee on Internal Revenue Taxation. A report to Congress shall be made annually by such committee of such refunds and credits, including the names of all persons and corporations to whom amounts are credited or payments are made, together with the amounts credited or paid to each.

The duty of examining the refunds submitted to the joint committee in accordance with the above provision was assigned to the division of investigation. The procedure followed is set forth in a letter to the chairman under date of December 28, 1928, which will be found in full in Appendix 1. It was concluded, as shown in this letter, that the intent of the Congress in enacting this provision could be analyzed as follows:

First. It appeared to be the purpose that the joint committee should inform the Congress not only as to the amounts of the refunds and credits over \$75,000, but also as to the principal causes of such repayments.

Second. It appeared to be the purpose that the joint committee and its staff should study these cases in order to inform themselves as to the practical operation and effect of our internal revenue system of taxation.

Third. It appeared to be the purpose that the joint committee, or its authorized agents, should call to the attention of the Bureau of Internal Revenue any final tax determinations resulting in refunds or credits which might seem erroneous, or doubtful, or worthy of further investigation and review.

The above-named purposes have been carefully kept in mind during the entire period during which refunds and credits have been submitted to the committee. It has been recognized, however, that the committee has no actual power of approval or disapproval of these refund cases.

This report will be divided into three parts as follows, covering the period June 1, 1928, to December 31, 1928, inclusive:

Part I. Tables showing the names of all persons and corporations to whom amounts in excess of \$75,000 have been credited and/or paid, together with the amounts credited and/or paid to each as required by section 710 quoted above. These tables also include related data, such as: Total original and additional assessments, abatements, interest, percentage of tax reduction, and the principal cause of the overassessment. The arrangement of the tables is alphabetically by months.

Part II. General survey of overassessments in excess of \$75,000. This survey classifies the overassessments in such manner as to show what provisions of our revenue acts have been the cause of controversy. Certain conclusions appear to be proper from such an analysis.

Part III. Study of individual cases. This study describes those individual cases which have appeared most interesting and instructive from the standpoint of the operation and effect of our internal revenue system of taxation and its administration.

Before presenting these three parts it seems proper to summarize the technical details included therein, for the benefit of those who may not care to study statistics and technical discussion. It is believed that the following facts and conclusions are important:

First. The total overassessments plus interest allowed in cases of over \$75,000 each amounted to \$106,569,893.99 for the 7-month period June 1, 1928, to December 31, 1928. The rate of refundment with interest was, therefore, \$15,224,270 per month. Similar overassessments for the 14-month period March 1, 1927, to April 24, 1928, amounted to \$117,630,055.44, which gives a rate of \$8,402,147 per month.

Second. It appears that the increase in the rate of refundment of nearly 80 per cent since June, 1928, is principally due to three factors: The decision of the Supreme Court of the United States in the National Life Insurance Co. case; the large refund to the United States Steel Corporation; and the drive of the bureau to settle old tax cases.

Third. The interest paid on the overassessments made in the 7-month period has amounted to \$22,473,308.38. This represents an average interest charge of 26.72 per cent.

Fourth. An analysis has been made of the overassessments reported for the 7-month period, June 1, 1928, to December 31, 1928, and those reported for the 14-month period, March 1, 1927, to April 24, 1928, taken together. This analysis shows as follows:

(a) Eighty-three per cent of the total overassessments reported involve the excess-profits tax years (1917 to 1921).

(b) Forty-two per cent of the total overassessments reported are caused principally by the three provisions—invested capital, special assessment, and amortization. These provisions have no application to taxable years since 1921. The two last-named provisions are special relief sections of the old revenue acts.

(c) Thirty-three per cent of the total overassessments are due principally to the adjustment of questions involving valuations. It appears fair to conclude that the most troublesome provisions of our present revenue act are those requiring such valuations, which are based largely on judgment.

(d) There appears to be a disproportion in the ratio of total income and estate taxes paid by States, and the ratio of the refunds allowed by States. For instance, New York State pays about 30 per cent of the taxes and receives 46 per cent of the refunds. The data is considered insufficient for definite conclusions from the above fact.

Fifth. In regard to the individual refunds, it appears that on the whole the action of the commissioner in making these allowances shows proper, just, and careful handling in the face of many difficulties. A few cases have appeared doubtful and a difference of opinion results. This is recognized as being inevitable in view of the complexity and uncertainty of certain provisions of our revenue acts.

Sixth. One case was withdrawn by the commissioner for correction on account of an error pointed out by this division. The saving which resulted was approximately \$193,000. The promptness with which this action was taken was evidence of the desire of the department to co-operate with this committee.

Part I, which consists of the complete list of taxpayers and the amounts refunded or credited to each, is next submitted. This part of the report includes all information required by the specific wording of section 710 of the revenue act of 1928, and has been compiled by Mr. W. L. Tucker, auditor for this committee.

L. H. PARKER,
Chief Division of Investigation.

PART I

(1)

PART I

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

JUNE, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
American Ice Co., Jersey City, N. J.	1924 and 1925.			\$96,398.58	\$729,803.25	\$96,398.58
American Locomotive Co., New York City.	1909 to 1913, 1916, 1917, 1918, and 1921.	\$12,862.73	\$317,369.97	562,765.69	8,096,936.18	\$62,878.39
Atlantic & Pacific Steamship Co., New York City	1918 and 1919.	23,423.85	55,765.45	331,298.39	523,486.70	410,487.69
Bostwick, Helen G., estate of, New York City	1920.	529.00		541,427.41	6,993,599.72	541,956.41
British & North Atlantic Steam Navigation Co. (Ltd.), New York City.	1917.	208,500.46			244,823.97	208,500.46
Butterick Co. and subsidiaries, New York City.	1922 to 1924, inclusive.			146,672.14	209,286.46	146,672.14
Campbell, Mrs. Sarah Rector, Kansas City, Mo.	1918.			121,820.25	225,514.66	121,820.25
Chatham & Phenix National Bank, New York City	1918 to 1920, inclusive.			117,959.03	1,338,699.23	117,959.03
Cole Motor Car Co., Indianapolis, Ind.	1918 to 1921, inclusive.			229,439.80	1,956,351.85	229,439.80
Connecticut Light & Power Co., New York City.	1922.			122,527.49	223,825.94	122,527.49
Duke, James B., estate of, New York City.	1920.			105,596.03	285,714.88	105,596.03
Eisenmann Bros., Boston, Mass.	1917.			193,672.08	1,080,625.03	193,672.08
Endicott, Henry B., estate of, Boston, Mass.	1920.			74,776.05	2,059,753.50	74,776.05
First National Bank, St. Louis, Mo.	1924 and 1925.			354,292.92	208,783.68	84,170.65
Gaus Steamship Line, New York City.	1917.		37,418.00		2,881,974.99	391,710.92
Goodwin, Josephine S., New York City.	1924.			105,822.43	140,865.00	105,822.43
Goodyear Tire & Rubber Co., ¹ Akron, Ohio.	1917 and 1919.			171,409.30	171,409.30	171,409.30
Holbrook, Edward, estate of, New York City.	1919.			77,291.59	872,418.78	77,291.59
Keith, B. F., Theaters Co. and affiliated companies, New York City.	1912, 1915, 1916, 1917, 1918, and 1921.	4,150.81	53,594.01	19,753.28	364,549.33	77,498.10
Lackawanna Steel Co. and subsidiaries, Lackawanna, N. Y.	1913, 1917, and 1918.		551,679.34	56,578.35	9,290,332.69	608,257.69
Lorillard, P. & Co., New York City.	1918.			1,231,006.78	5,010,317.94	1,231,006.78
Maryland Coal Co., New York City.	1920.			110,414.81	153,751.86	110,414.81
Michigan Tanning & Extract Co., Petoskey, Mich.	1917.			147,331.72	682,290.68	147,331.72
National Supply Co. of Ohio, Toledo, Ohio.	1917 to 1920, inclusive.	20,912.37	17,399.43	180,553.58	7,852,521.90	218,865.38
New England Westinghouse Co., East Pittsburgh, Pa. ²	1919.		970,378.09	146,950.70	3,611,731.89	1,117,328.79
Pillsbury Flour Mills Co., Minneapolis, Minn.	1918.	232,798.61	220,770.25		535,499.98	453,568.86
Scraps, James E., estate of, Detroit, Mich.	1923 and 1924.		223,879.91		223,879.91	223,879.91
Seiple, John B. & Co., Sewickley, Pa.	1917 and 1918.			423,395.63	2,802,670.08	423,395.63
Standard Tool Co., Cleveland, Ohio.	1917-1920, inclusive.			107,369.35	4,792,328.77	407,369.35
Thayer Action Co., Rockford, Ill.	1917-1921, inclusive.			92,533.56	5,525,514.81	92,533.56
The Tribune Co., Chicago, Ill.	1920 and 1921.			133,447.11	1,752,507.76	133,447.11
Vacuum Oil Co., New York City.	1918 and 1919.	3,000,000.00	1,120,381.22		4,697,797.75	4,120,381.22
Western Pacific R. R. Corporation, New York City	1918.			238,169.34	333,575.07	238,169.34

White Oil Corporation, Houston, Tex.	1920	269, 228.98	77, 422.41	1, 457.60	274, 399.44	270, 686.58
Williams Oil-O-Matic Heating Corporation, Bloomington, Ill.	1924				101, 341.97	77, 422.41
Total			3, 772, 406.81	3, 645, 998.09	6, 325, 641.64	13, 744, 040.54

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
American Ice Co., Jersey City, N. J.			\$633, 404.67	\$11, 829.23	<i>Per cent</i> 13.21	Depreciation, increase in allowance for.
American Locomotive Co., New York City			4, 299, 723.55	362, 992.67	46.87	Do.
Atlantic & Pacific Steamship Co., New York City	\$2, 901, 939.36	\$2, 388.88	112, 999.01	183, 380.02	78.41	Amortization, allowance for.
Boswick, Helen G., estate of, New York City			6, 451, 643.31	133, 790.80	7.75	Estate tax, reduction in (exclusion of trust property from estate).
British & North Atlantic Steam Navigation Co. (Ltd.), New York City			36, 323.51		85.16	Reallocation of income from sources within and without the United States (T. D. 3387).
Butlerick & Co. and subsidiaries, New York City	62, 536.11			31, 347.58	99.96	Miscellaneous (income adjustments and credit for foreign taxes).
Campbell, Mrs. Sarah Rector, Kansas City, Mo.			61, 578.50	63, 601.92	72.69	Depletion, increase in allowance for.
Chatham & Phenix National Bank, New York City	42, 115.91	29, 301.11	1, 211, 439.09	21, 691.22	8.68	Special assessment (secs. 327 and 328, 1918 act).
Cole Motor Car Co., Indianapolis, Ind.		24, 993.13	1, 701, 918.92	88, 081.04	11.72	Do.
Connecticut Light & Power Co., New York City			101, 298.45	7, 553.06	54.74	Affiliation (sec. 240, revenue act of 1921).
Duke, James B., estate of, New York City			180, 118.85	14, 672.06	36.95	Valuations (capital loss, correction in surtax, and credit for foreign taxes).
Eisemann Bros., Boston, Mass.	10, 219.71		877, 333.24	117, 538.58	18.81	Special assessment (sec. 210, 1917 act).
Endicott, Henry B., estate of, Boston, Mass.	35, 275.00		1, 949, 702.45	28, 656.76	5.34	Estate tax reduction in (additional expense items allowed).
First National Bank, St. Louis, Mo.			184, 613.03	10, 755.02	31.32	Miscellaneous (allowance for accrued and local taxes).
Gans Steamship Line, New York City	631, 762.36		1, 858, 501.71	216, 803.52	35.51	Special assessment (sec. 210, 1917 act).
Goodwin, Josephine S., New York City	44, 042.57			20, 809.32	100.00	Gift tax (illegal under Supreme Court decision).
Goodyear Tire & Rubber Co., Akron, Ohio				55, 277.75		Miscellaneous (former overassessment improperly adjusted due to error in commissioner's records).
Holbrook, Edward estate of, New York City			277, 867.79	25, 531.63	68.15	Estate tax (gift held not to be in contemplation of death).
Keith, B. F., Theatres Co. and affiliated companies, New York City	517, 259.40		286, 896.28	13, 720.76	21.31	Miscellaneous (amortization of booking contracts and depreciation).
Lackawanna Steel Co. and subsidiaries, Lackawanna, N. Y.	185.00		8, 652, 125.00	67, 825.65	65.68	Valuations (loss on sale of capital assets, depreciation, and depletion).
Lorillard, P., & Co., New York City	265, 035.38		3, 514, 275.78	199, 591.72	29.85	Special assessment (secs. 327 and 328, 1918 act).
Maryland Coal Co., New York City	13, 553.05	15, 400.71	14, 383.29	45, 803.14	80.63	Loss of useful value.
Michigan Lanning & Extract Co., Peoskey, Mich.			534, 967.96	72, 999.56	21.59	Special assessment (sec. 210, 1917 act).
National Supply Co. of Ohio, Toledo, Ohio			7, 633, 656.52	96, 058.70	2.79	Special assessment (secs. 327 and 328, 1918 act), also depreciation.
New England Westinghouse Co., East Pittsburgh, Pa. ¹			2, 494, 403.10	67, 007.50	30.94	Special assessment (secs. 328 and 328, 1918 act).
Pillsbury Flour Mills Co., Minneapolis, Minn.			81, 901.12		84.70	Reallocation of income.
Scrappys, James E., estate of, Detroit, Mich.				45, 750.81	100.00	Estate tax, reduction in (deductions of income paid to legatees allowed).

¹ Excess collection which was not assessed.

² Includes excess collection of \$229.31 which was not assessed.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1923—Continued

JUNE, 1928—Continued

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
Sample, John B., & Co., Sewickley, Pa.	\$534, 206.16	-----	\$1, 945, 068. 29	\$209, 992. 63	<i>Per cent</i> 30. 59	Special assessment (sec. 210, 1917 act; secs. 327 and 328, 1918 act).
Standard Tool Co., Cleveland, Ohio.	60, 182. 54	-----	4, 594, 776. 88	53, 606. 25	3. 52	Depreciation, increase in allowance for.
Thayer Action Co., Rockford, Ill.	2, 155. 32	-----	430, 825. 93	36, 844. 32	18. 02	Special assessment (secs. 327 and 328, 1918 act.)
The Tribune Co., Chicago, Ill.	-----	-----	1, 619, 060. 65	49, 717. 74	1. 91	Special assessment (secs. 327 and 328, 1918 act.) (Also operating loss of company in France.)
Vacuum Oil Co., New York City.	-----	-----	487, 386. 52	321, 783. 17	89. 42	Miscellaneous. (Exclusion of foreign dividends and amortization.)
Western Pacific R. R. Corporation, New York City.	-----	-----	95, 705. 73	68, 378. 75	71. 33	Miscellaneous. (Elimination from 1918 income of compensation for Federal control which was deemed income in the year of final settlement, 1921.)
White Oil Corporation, Houston, Tex.	-----	-----	3, 712. 86	580. 20	98. 64	Depreciation, increase in allowance for. (Also depletion.)
Williams Oil-O-Matic Heating Corporation, Bloomington, Ill.	-----	-----	23, 919. 56	10, 977. 62	76. 40	Miscellaneous. (Income of predecessor company eliminated.)
Total	5, 020, 467. 87	\$72, 083. 83	52, 351, 579. 76	2, 754, 955. 70	-----	

Distribution of above abatements, credits, and refunds in cases where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds
B. F. Keith New York Theaters Co., New York City ¹	1912-1915, 1916, 1917		\$211. 96	\$11, 165. 48
B. F. Keith Theaters Co. and subsidiaries, Boston, Mass. ¹	1918	\$4, 150. 81	45, 052. 49	8, 587. 80
B. F. Keith Enterprises, Boston, Mass. ¹	1921		8, 329. 56	
B. F. Keith Iron Mining Co., Cleveland, Ohio ²	1917		60. 12	342. 19
Ellsworth Collieries Co., Lackawanna, N. Y. ²	1917			56, 225. 81
Ellsworth Land Co., Ellsworth, Pa. ²	1918			10. 35
Lackawanna Steel Co., Lackawanna, N. Y. ²	1913, 1917		188, 301. 27	

¹ Affiliated companies of B. F. Keith Theater Co.

² Subsidiaries of Lackawanna Steel Co.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

JULY, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
Aluminum Co. of America and subsidiaries, Pittsburgh, Pa.	1917	\$623.42	\$665, 177. 18	\$621, 620. 04	\$8, 078, 961. 55	\$1, 287, 426. 64
American Hide & Leather Co., Boston, Mass.	1918			94, 835. 16	1, 452, 619. 46	94, 835. 16
American Manufacturing Co., Brooklyn, N. Y.	1923, 1925, inclusive			99, 117. 73	451, 157. 41	99, 117. 73
American Power & Light Co., New York City	1922 and 1923			141, 072. 35	1, 123, 198. 72	141, 072. 35
American Telephone & Telegraph Co. and subsidiaries, New York City.	1918 and 1920	26, 796. 42	625, 518. 63	17, 627. 45	669, 942. 50	669, 942. 50
Burnham, Wm. Addison, estate of, Boston, Mass.	1923			118, 967. 25	166, 691. 40	118, 967. 25
Deering, Charles, Chicago, Ill.	1924			604, 258. 72	770, 378. 38	604, 258. 72
Grace, W. R., & Co., New York City	1918, 1920, inclusive		234, 982. 53	2, 373, 297. 54	6, 044, 645. 38	2, 608, 280. 07
Kenedy, John G., Sarita, Tex.	1924			75, 088. 52	75, 088. 52	75, 088. 52
Knowlton, Geo. W., estate of, Worcester, Mass.	1924		457, 557. 24	120, 095. 64	177, 970. 30	120, 095. 64
Long Bell Lumber Corporation, Kansas City, Mo.	1925				511, 582. 03	457, 557. 24
Macy, Edith Carpenter, estate of, New York City	1917 and 1918		749, 499. 16	78, 213. 18	321, 611. 04	78, 213. 18
New York Life Insurance Co., New York City	1919		145, 616. 66	1 675, 691. 90	1, 442, 211. 13	1, 445, 616. 06
Oceanic Steamship Navigation Co., New York City	1923			154, 121. 16	1, 047, 470. 66	154, 121. 16
Philadelphia Electric Co., Philadelphia, Pa.	1918		206, 045. 82		1, 206, 045. 82	206, 045. 82
Rubay Co., Cleveland, Ohio	1924			78, 149. 03	116, 095. 30	78, 149. 03
Schmidt, Helen S., Derby, N. Y.	1922	113, 043. 00	35, 641. 89		287, 300. 00	148, 684. 89
Tarso Corp., Pawtucket, R. I.	1919			235, 581. 46	235, 581. 46	235, 581. 46
Taylor, John, estate of, ² Kansas City, Mo.	1921			77, 576. 34	315, 934. 83	77, 576. 34
Uihlein, Edward G., estate of, Chicago, Ill.	1923 and 1924		101, 163. 35		902, 261. 62	101, 163. 35
Union Trust Co., Pittsburgh, Pa.	1923, 1925, inclusive			549, 943. 20	1, 201, 932. 86	549, 943. 20
United States Industrial Alcohol Co., New York City						
Total		140, 462. 84	3, 221, 202. 46	6, 115, 862. 67	26, 024, 451. 43	9, 477, 527. 97

¹ Unadjusted, appeal pending.

² Excess collection which was not assessed.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928—Continued

JULY, 1928—Continued

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
Aluminum Co. of America and subsidiaries, Pittsburgh, Pa.			\$6,791,534.91		<i>Per cent</i> 15.94	Inventory adjustment.
American Hide & Leather Co., Boston, Mass.			708,968.47		20.73	Change in accounting period.
American Manufacturing Co., Brooklyn, N. Y.	\$206,348.22	\$443,367.61	352,039.68	\$25,302.80	21.97	Depreciation, increase in allowance for.
American Power & Light Co., New York City.			982,126.37	34,394.63	12.56	Do.
American Telephone & Telegraph Co. and subsidiaries, New York City.				2,072.64	100.00	Affiliation (sec. 240, 1918 act).
Burnham, Wm. Addison, estate of, Boston, Mass.			47,694.15	16,158.35	71.38	Estate tax, reduction in (gift held not in contemplation of death).
Deering, Charles, Chicago, Ill.	166,119.66			123,831.64	100.00	Gift tax (illegal under Supreme Court decision).
Grace, W. K., & Co., New York City			3,436,365.31	1,137,199.31	43.15	Invested capital (also numerous income adjustments).
Kenedy, John G., Sarita, Tex.				11,810.51	100.00	Gift tax (illegal under Supreme Court decision).
Knowlton, Geo. W., estate of, Worcester, Mass.				24,532.41	100.00	Do.
Long Bell Lumber Corp., Kansas City, Mo.	57,874.66		54,024.79	78,293.22	89.44	Depreciation, increase in allowance for.
Macy, Edith Carpenter, estate of, New York City			243,897.86		24.31	Estate tax, reduction in (retroactive rates of 1926 act).
New York Life Insurance Co., New York City					100.00	Miscellaneous inclusion of legal reserves in invested capital (Supreme Court decision).
Oceanic Steam Navigation Co., New York City			296,594.47		32.93	Special assessment (also T. D. 3357 income from sources within the United States).
Philadelphia Electric Co., Philadelphia, Pa.			893,849.50	33,845.43	14.71	Depreciation, increase in allowance for.
Rubey Co., Cleveland, Ohio.				274.08	103.00	Change in accounting period.
Schmidt, Helen S., Derby, N. Y.	37,876.27			15,520.82	100.00	Gift tax (illegal under Supreme Court decision).
Tarsoe Corp., Pawtucket, R. I.			138,675.11		51.74	Change in accounting period.
Taylor, John, estate of, ¹ Kansas City, Mo.				61,677.16		Estate tax, reduction in (transfers not made in contemplation of death).
Uihlein, Edward C., estate of, Chicago, Ill.			238,358.49	11,605.62	24.55	Estate tax, reduction in (follows Supreme Court decision).
Union Trust Co., Pittsburgh, Pa.			801,098.27	12,720.03	11.21	Miscellaneous, loss on bonds.
United States Industrial Alcohol Co., New York City.			652,009.66	120,220.83	45.75	Inventory adjustment (also depreciation and net loss).
Total	468,218.81	443,367.61	15,635,337.04	1,721,585.71		

¹ Excess collection which was not assessed.

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds
Aluminum Co. of America, Pittsburgh, Pa. ¹	1917	-----	\$665,177.18	\$620,538.70
Aluminum Cooking Utensil Co., Pittsburgh, Pa. ¹	1917	-----	-----	-----
Aluminum Ore Co., Pittsburgh, Pa. ¹	1917	\$8.50	-----	-----
American Bauxite Co., Pittsburgh, Pa. ¹	1917	171.01	-----	-----
Electric Carbon Co., Pittsburgh, Pa. ¹	1917	-----	-----	1,008.16
St. Lawrence River Power Co., Pittsburgh, Pa. ¹	1917	13.88	-----	-----
American Telephone & Telegraph Co. and subsidiaries (see special analysis attached).	1917	430.03	-----	19.18
W. R. Grace & Co., New York City	1918, 1919, 1920	-----	234,982.53	2,373,267.93
Lubricating Products Co., New York City ²	1917	-----	29.61	29.61

¹ Subsidiary of Aluminum Co. of America.

² Subsidiary of W. R. Grace & Co.

Special analysis of abatements, refunds, and credits for American Telephone & Telephone Co. and subsidiaries

Company	Location	Year	Abate-ments	Credits	Refunds
Aroostook Telephone & Telegraph Co.	Boston, Mass.	1918	-----	-----	\$2,305.80
Asheville Telephone & Telegraph Co.	Atlanta, Ga.	1920	\$527.96	-----	-----
Boone County Telephone Co.	Omaha, Nebr.	1920	2,121.90	-----	-----
Booneville Telephone Co.	St. Louis, Mo.	1920	566.74	-----	-----
Butte Protective Co.	Denver, Colo.	1920	22.11	-----	-----
Citizens Telephone Exchange.	Sheboygan, Wis.	1920	1,969.72	-----	-----
Franklin County Telephone Co.	Boston, Mass.	1918	-----	-----	801.96
Granville Telephone Co.	do.	1919	-----	-----	983.68
Hamlin Rural Telephone Co.	Hamlin, N. Y.	1920	78.11	-----	-----
Independent Telephone Co. of Council Bluffs.	Omaha, Nebr.	1920	2,894.28	-----	-----
Indiana Union Telephone & Telegraph Co.	Indianapolis, Ind.	1920	80.84	-----	-----
Maine Telephone & Telegraph Co.	Boston, Mass.	1918	-----	-----	1,949.19
McKinney Telephone Co.	McKinney, Tex.	1920	243.31	-----	-----
Middleton Telephone Co.	Middletown, Ohio.	1920	2,511.16	-----	-----
Missouri Central Telephone Co.	St. Louis, Mo.	1920	256.65	-----	-----
Mills County Telephone Co.	Omaha, Nebr.	1920	6.12	-----	-----
Moosehead Telephone & Telegraph Co.	Boston, Mass.	1918	-----	-----	800.55
New Carlisle Telephone Co.	New Carlisle, Ohio.	1920	190.08	-----	-----
New England Telephone and Telegraph Co.	Boston, Mass.	1918	-----	\$623,396.73	2,521.85
New Home Telephone Co.	Indianapolis, Ind.	1918	-----	-----	671.19
North Dakota Independent Telephone Co.	Omaha, Nebr.	1920	2,228.09	-----	-----
Northwestern Bell Telephone Co.	do.	1920	-----	-----	334.20
Painsville Telephone Co.	Painsville, Ohio.	1920	63.45	-----	-----
Peoples Home Telephone Co.	Leavenworth, Kans.	1920	995.75	-----	-----
Rochester Telephone Co.	Rochester, N. Y.	1920	-----	-----	6,376.96
Southern Telephone Co. of Indiana.	Evansville, Ind.	1920	4,377.08	-----	-----
Standard Telephone Co.	Omaha, Nebr.	1920	558.10	-----	-----
Tri State Telephone Co.	Denver, Colo.	1920	5,932.16	-----	-----
Thousand Island Telephone Co.	Clayton, N. Y.	1920	172.87	-----	-----
United Telephone Co.	Bluffton, Ind.	1920	2,812.25	-----	-----
White Mountain Telephone & Telegraph Co.	Boston, Mass.	1918	-----	-----	871.71
Wisconsin Telephone Co.	Milwaukee, Wis.	1920	-----	-----	10.86
Wray Telephone Co.	Denver, Colo.	1920	309.56	-----	-----

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

AUGUST, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
American Oak Leather Co., Cincinnati, Ohio.	1919.			\$86,827.12	\$585,566.97	\$86,827.12
Cadillac Chemical Co., Cadillac, Mich.	1917 and 1918.			221,301.88	576,723.50	221,301.88
Carleton Ferguson Dry Goods Co., St. Louis, Mo.	1923.		\$7,493.86	69,468.13	93,813.72	76,961.99
Cities Service Co., New York City.	1917.			82,106.73	2,618,046.85	82,106.73
Cleveland-Cliffs Iron Co., Cleveland, Ohio.	1918.			115,361.45	563,724.38	191,997.27
Czarnikow-Roanda Co., New York City.	1920.	\$20,227.94	56,407.88	178,474.90	2,024,721.07	178,474.90
Edison Electric Illuminating Co., Boston, Mass.	1922-23.			105,454.21	1,036,182.32	105,454.21
Fulton Iron Works Co., St. Louis, Mo.	1918.		92,636.73	4,085.69	589,406.66	96,722.42
Hoehschild, Berthold, New York City.	1917.		32,335.36	123,390.77	433,466.97	123,736.13
International Curtis Marine Turbine Co., Jersey City, N. J. 1.	1918, 1919, and 1921.			183,645.04	615,049.22	100,308.54
Kelly-Springfield Tire Co., New York City.	1918.		4,732.60	599,888.54	2,656,736.23	599,888.54
Reliance Life Insurance Co., Pittsburgh, Pa.	1913, 1919, 1920.	18,216.64	175,675.84	25,488.07	330,939.73	219,380.55
Leaver Bros. Co. and subsidiary, Cambridge, Mass.	1917.		63,239.00	32,206.78	469,517.03	95,443.78
Pittsburgh Steel Products Co., Pittsburgh, Pa.	1919.		141,374.04		534,217.04	141,374.04
Remington Arms Co. (Inc.), New York City.	1923 to 1926, inclusive.			114,880.98	137,781.57	114,880.98
Rockefeller, John D., st., New York City.	1922 and 1923.			136,433.53	363,348.08	136,433.53
Schiff, Mortimer, L., New York City.	1922.			120,655.28	133,014.30	120,655.28
Standard Oil Co. (Kentucky), Louisville, Ky.	1919, 1920, 1921.			381,658.32	708,531.78	381,658.32
Westinghouse Electric & Manufacturing Co., East Pittsburgh, Pa.	1918, 1919, 1920.			1,842,055.42	4,285,387.09	1,842,055.42
Widener, P. A. B., estate of, Philadelphia, Pa.	1920 and 1921.		232,133.26		12,291,854.25	1,165,340.25
Woerishoffer, Anna, New York City.	1924.			98,970.92		232,133.26
Yellow Taxi Corporation, New York City.	1924 and 1925.			98,698.16	130,805.52	98,970.92
Total.		38,444.58	774,048.57	5,788,393.37	31,953,732.26	6,600,886.52

¹ Includes excess collection of \$23,392.96 which was not assessed.

² Includes excess collection of \$3,188.19 which was not assessed.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928—Continued

AUGUST, 1928—Continued

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
American Oak Leather Co., Cincinnati, Ohio.	-----	-----	\$498,739.85	\$40,388.88	<i>Per cent</i>	Inventory adjustment.
Cadillac Chemical Co., Cadillac, Mich.	-----	-----	454,421.62	124,250.35	14.83	Special assessment (secs. 327 and 328, 1918 act).
Carleton Ferguson Dry Goods Co., St. Louis, Mo.	-----	-----	16,851.73	16,198.04	32.75	Miscellaneous.
Cities Service Co., New York City	-----	-----	2,535,940.12	3,392.24	82.04	Miscellaneous. (Error in computation of tax.)
Cleveland-Cliffs Iron Co., Cleveland, Ohio.	-----	-----	371,727.11	34,905.49	31.36	Amortization. (Also invested capital.)
Czarnikow Rionda Co., New York City	-----	-----	1,358,677.31	34,448.05	34.06	Special assessment. (Secs. 327 and 328, 1918 act.)
Edison Electric Illuminating Co., Boston, Mass.	\$487,568.86	-----	930,728.11	28,793.11	32.90	Depreciation, increase in allowance for.
Fulton Iron Works Co., St. Louis, Mo.	-----	-----	492,684.24	19,851.64	10.18	Amortization, allowance for.
Hochschild, Berthold, New York City	-----	-----	172,340.00	40,136.24	16.41	Change in method of reporting income.
International Curtis Marine Turbine Co., Jersey City, N. J. ¹	137,400.78	-----	424,650.68	53,102.37	30.65	Special assessment. (Secs. 327 and 328, 1918 and 1921 acts.)
Kelly-Springfield Tire Co., New York City	-----	-----	1,927,241.67	315,892.53	27.46	(Also depreciation, allowance for.
Lever Bros. Co. and subsidiary, Cambridge, Mass.	129,628.02	-----	331,559.18	51,138.06	39.82	Do.
Loeb, Carl M., New York City	-----	-----	160,760.55	3,299.43	65.76	Change in method of reporting income.
Pittsburgh Steel Products Co., Pittsburgh, Pa.	213,310.70	-----	392,843.00	7,557.02	28.46	Amortization, allowance for.
Reliance Life Insurance Co., Pittsburgh, Pa.	307.92	\$2,795.84	19,796.83	17,022.23	83.60	Supreme Court decision—Insurance company. (Tax-exempt interest.)
Remington Arms Co. (Inc.), New York City	-----	-----	226,914.25	36,358.25	37.55	Miscellaneous. (Expenses erroneously capitalized.)
Rockefeller, John D., sr., New York City	322.99	-----	12,036.03	36,571.86	90.95	Valuations. (Profit on sale of stock.)
Schiff, Mortimer, L., New York City	-----	-----	326,873.46	42,069.80	53.87	Estate tax. (Deduction in New York State transfer tax.)
Standard Oil Co. (Kentucky), ² Louisville, Ky.	19,439.01	-----	2,423,892.66	772,497.12	43.44	Supreme Court decision.
Westinghouse Electric & Manufacturing Co., East Pittsburgh, Pa.	267,118.93	-----	10,859,395.10	333,293.98	11.35	Special assessment. (Sections 327 and 328, 1918 and 1921 acts.)
Widener, P. A. B., estate of, Philadelphia, Pa.	-----	-----	74,932.99	91,011.30	79.00	Amortization. (Also invested capital.)
Wernshofer Anna, New York City	49,840.84	-----	-----	20,036.73	79.00	Depreciation. (Also loss on sale of assets.)
Yellow Taxi Corporation, New York City	-----	-----	32,107.36	15,116.88	100.00	Gift tax. (Illegal under Supreme Court decision.)
Total	1,304,936.05	2,795.84	24,045,113.85	2,167,772.60	73.45	Depreciation, increase in allowance for.

¹ Includes excess collection of \$23,392.96 which was not assessed.

² Includes excess collection of \$3,188.19 which was not assessed.

Distribution of above credits and refunds in cases where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved			A bate ments	Credits	Refunds
Cadillac Chemical Co., Cadillac, Mich.	1918	-----	-----	-----	-----	\$23,509.37
Mitchell-Diggins Iron Co., Cadillac, Mich. ³	1918	-----	-----	-----	-----	197,792.51

³ Subsidiary of Cadillac Chemical Co.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

SEPTEMBER, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
Aetna Life Insurance Co., Hartford, Conn.	1925-26		\$1,214,580.62	\$172,094.54	\$172,094.54	\$172,094.54
American Woolen Co., Boston, Mass.	1919			2,826,421.04	2,826,421.04	1,214,580.62
Brown, E. G., Iron Co., Birdshoro, Pa.	1918, 1919, 1920			118,761.58	5,972,065.23	254,728.44
Brooks & Sharpe Manufacturing Co., Providence, R. I.	1918, 1919, 1920	\$60,966.86	176,337.24	284,254.27	5,893,167.11	160,991.91
Chandler Motor Car Co., Cleveland, Ohio	1919			121,244.87	2,680,521.75	121,244.87
De Nederlandsche Bank, Amsterdam, Holland	1920 to 1923, inclusive		27,031.88	210,672.99	396,496.97	237,704.87
Diamond Match Co., New York City	1916 and 1917		522,866.41		1,155,512.83	522,866.41
John Hancock Mutual Life Insurance Co., Boston, Mass.	1927	134,665.91		30,721.30	538,663.70	165,387.21
Kolb, Louis J., et al., Philadelphia, Pa.	1926		1,580,573.50		1,779,068.03	1,580,573.50
Lamb, F. G., Pittsburgh, Pa.	1919 and 1920		83,983.44		96,457.79	83,983.44
Metropolitan Life Insurance Co., New York City	1917, 1918, 1919, and 1922		1 25,315.31	55,587.96	1 034,583.99	80,903.27
Mutual Benefit Life Insurance Co., Newark, N. J.	1927	444,743.33			3,100,490.49	444,743.33
Mutual Life Insurance Co., of New York, New York City	1924 to 1926, inclusive				1,570,851.59	651,439.03
National Life Insurance Co., Montpelier, Vt.	1909, 1911, and 1912			651,439.63	92,296.33	92,296.33
National Life Insurance Co., Montpelier, Vt.	1925 and 1926			270,587.28	270,587.28	270,587.28
National Life Insurance Co., Montpelier, Vt.	1927	96,873.59		28,023.77	129,164.79	124,897.36
Northwestern Mutual Life Insurance Co., Milwaukee, Wis. ¹	1921 to 1923, inclusive			986,986.59	2,487,851.64	986,986.59
Northwestern Mutual Life Insurance Co., Milwaukee, Wis.	1926 and 1927	254,911.25		324,811.70	2,014,189.65	579,722.95
Odin Elevator Co. of New Jersey, New York City	1909, 1910, 1911, 1915, 1917, 1918, 1920, 1922, and 1923, 1919		212,805.33		2,914,372.29	212,805.33
Parke, Davis & Co., Detroit, Mich.	1919		1 51,961.62	79,894.95	1,463,020.72	131,786.57
Plume & Atwood Manufacturing Co., Waterbury, Conn.	1917, 1918, and 1920		69,791.23	56,212.42	738,856.69	126,003.65
Provident Mutual Life Insurance Co., Philadelphia, Pa.	1923			121,290.23	162,290.23	121,290.23
Prudential Insurance Co. of America, Newark, N. J.	1925 and 1926			1,503,219.02	3,283,410.61	1,503,219.02
Sherwin-Williams Co., Cleveland, Ohio	1918 and 1920	110.48		154,299.57	1,652,553.82	154,410.05
Standard Gas & Electric Co., Chicago, Ill.	1926 and 1927			190,592.67	193,804.79	190,592.67
Standard Oil Co. of New York, and subsidiaries, New York City	1915 to 1918, inclusive	2,325,781.21	517,108.47	225,802.68	40,130,984.35	3,068,692.36
Timken Detroit Axle Co., Detroit, Mich.	1918	7,530.28		177,484.03	1,906,432.44	783,288.65
Union Central Life Insurance Co., Cincinnati, Ohio	1925 and 1926		598,274.34	85,790.18	641,869.06	85,790.18
Zeluckner, Walter A., Supply Co., St. Louis, Mo. ²	1918 and 1919			118,554.79	118,554.79	118,554.79
Total		3,325,582.91	5,080,629.39	6,135,463.35	80,100,630.12	14,541,675.65

¹ Unadjusted; appeal pending.

² Includes excess collection of \$158.85 which was not assessed.

³ Includes excess collection of \$5,026.91 which was not assessed.

⁴ Includes excess collection of \$3.75 which was not assessed.

⁵ Excess collection.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928—Continued

SEPTEMBER, 1928—Continued

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
Aetna Life Insurance Co., Hartford, Conn.				\$21,708.45	<i>Per cent</i> 100.00	Supreme Court decision; insurance company (tax-exempt interest).
American Woolen Co., Boston, Mass.			\$1,611,840.42		42.97	Inventory adjustment and exclusion of profit on sale of own stock.
Brooke, E. G. Iron Co., Birdsboro, Pa.	\$11,230.52		706,106.27	98,669.31	27.36	Invested capital.
Brown & Sharpe Manufacturing Co., Providence, R. I.			5,432,575.60	144,718.93	7.82	Amortization, allowance for.
Chandler Motor Car Co., Cleveland, Ohio.			1,929,276.88	57,124.60	5.91	Special assessment (secs. 327 and 328, revenue act, 1918).
De Nederlandsche Bank, Amsterdam, Holland.	8,183.52	\$11,991.39	138,647.19	43,600.88	62.01	Change in accounting period and method of reporting income.
Diamond Match Co., New York City.			632,646.42	74,223.97	45.25	Miscellaneous (income adjustments and increase in invested capital).
John Hancock Mutual Life Insurance Co., Boston, Mass.			373,276.49	153.61	30.70	Supreme Court decision; insurance company (tax-exempt interest).
Kolb, Louis J., et al., Philadelphia, Pa.			198,494.53	100,256.51	88.84	Reallocation of income; transfer from 1926 to 1925.
Lamb, F. G., Pittsburgh, Pa.			12,474.35		87.68	Miscellaneous (exclusion of undistributed earnings from income due to denial of personal service classification).
Merrell-Soule Co., Syracuse, N. Y.			953,950.72	24,551.07	7.82	Depreciation, increase in allowance for (3-1-13 value of patents and sec. 204 (b), 1921 act).
Metropolitan Life Insurance Co., New York City.			2,655,747.16		14.34	Supreme Court decision; insurance company (tax-exempt interest).
Mutual Benefit Life Insurance Co., Newark, N. J.			919,411.96	81,873.04	41.47	Do.
Mutual Life Insurance Co. of New York, New York City.	755.23		342,980.35	89,813.15	21.34	Miscellaneous (dividends applied to pay renewal premiums nontaxable).
National Life Insurance Co., Montpelier, Vt. ²		89,931.27		27,877.67	100.00	Supreme Court decision; insurance company (tax-exempt interest).
National Life Insurance Co., Montpelier, Vt.				999.26	96.70	Do.
Northwestern Mutual Life Insurance Co., Milwaukee, Wis. ³	623,601.53		787,332.25	277,130.93	64.70	Do.
Northwestern Mutual Life Insurance Co., Milwaukee, Wis.			1,434,466.70	18,061.11	28.78	Do.
Ohio Elevator Co. of New Jersey, New York City.		1,445.04	2,730,121.32	11,324.44	7.23	Miscellaneous (bonuses paid to employees).
Parke, Davis & Co., Detroit, Mich.			1,331,234.15	37,675.19	9.01	Miscellaneous (shrinkage in foreign exchange).
Prune & Atwood Manufacturing Co., Waterbury, Conn.			612,853.04	42,252.96	17.05	Inventory adjustments.
Provident Mutual Life Insurance Co., Philadelphia, Pa.		41,000.00		28,112.65	100.00	Supreme Court decision; insurance company (tax-exempt interest).
Prudential Insurance Co. of America, Newark, N. J.			1,780,191.59	130,402.60	43.78	Do.
Sherwin-Williams Co., Cleveland, Ohio.	51,422.31		1,446,721.46	67,937.90	12.46	Amortization, allowance for.

Standard Gas & Electric Co., Chicago, Ill. ⁴	-----	-----	-----	77, 294. 07	98. 30	Affiliation and depreciation.
Standard Oil Co. of New York, and subsidiaries, New York City.	-----	49, 330. 16	37, 012, 961. 83	113, 095. 12	7. 77	Amortization and Court of Claims decision.
Timken Detroit Axle Co., Detroit, Mich.	-----	-----	1, 123, 143. 79	69, 784. 43	41. 09	Miscellaneous (transfer of income from Government con- tracts from 1918 to 1919).
Union Central Life Insurance Co., Cincinnati, Ohio.	-----	-----	556, 068. 88	6, 328. 20	13. 37	Supreme Court decision; insurance company (tax-exempt interest).
Zelnicker, Walter A., Supply Co., St. Louis, Mo. ⁴	-----	-----	-----	31, 613. 23	-----	Reallocation of 1918 income to 1917.
Total.	-----	744, 493. 27	64, 730, 092. 90	1, 677, 203. 28	-----	

⁴ Includes excess collection of \$158.85 which was not assessed.⁵ Includes excess collection of \$5,026.91 which was not assessed.⁴ Includes excess collection of \$3.75 which was not assessed.⁵ Excess collection.

Distribution of above abatements, credits, and refunds in cases where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds
Birdsboro Steel Foundry & Machine Co., Washington, D. C.	1918, 1919, 1920	\$46, 896. 08	-----	\$111, 788. 05
Brooke Iron Co., E. G., Washington, D. C.	1917	14, 070. 78	-----	81, 973. 53
Miss Emma V. Kolb, Philadelphia, Pa.	1926	-----	\$128, 059. 78	-----
Miss Sarah E. Kolb, Philadelphia, Pa.	1926	-----	128, 059. 78	-----
Mr. Edward O. Kolb, Philadelphia, Pa.	1926	-----	171, 265. 84	-----
Mr. Louis J. Kolb, Philadelphia, Pa.	1926	-----	982, 019. 01	-----
Mr. Emanuel G. Kolb, Philadelphia, Pa.	1926	-----	171, 169. 09	-----
Detroit Paint & Glass Co., Detroit, Mich.	1918	110. 48	-----	-----
Sherwin Williams Co., Cleveland, Ohio.	1918, 1920	-----	-----	154, 299. 57
Standard Gas & Electric Co., Chicago, Ill.	1920, 1921	-----	-----	118, 023. 43
Western States Gas & Electric Co. of Delaware, Chicago, Ill.	1920, 1921	-----	-----	72, 474. 24

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

OCTOBER, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net overassessments
Cleveland Twist Drill Co., Cleveland, Ohio.....	1918 and 1920.....		\$293,610.51	-----	\$3,484,460.66	\$293,610.51
Columbian National Life Insurance Co., Boston, Mass.....	1921 to 1924, inclusive.....			\$88,944.96	145,670.08	88,944.96
Connecticut Mutual Life Insurance Co., Hartford, Conn.....	1924 and 1926.....			142,394.48	217,438.33	142,394.48
Crane Co., Chicago, Ill.....	1917 and 1918.....	\$7,625.07	414,694.52 + 167,718.59		16,140,051.37	590,038.18
Crane, Frederick G., estate of, Dalton, Mass.....	1917 and 1919.....		6,684.63	76,901.72	99,943.54	83,586.35
Equitable Life Insurance Co. of Iowa, Des Moines, Iowa.....	1923 to 1926.....			79,630.55	396,622.33	79,630.55
Galloway Coal Co., Memphis, Tenn.....	1918, 1920, 1921, 1923, 1924, and 1925.....			82,588.90	503,204.94	82,588.90
Marine Securities Co., Evanston, Ill.....	1919 and 1920.....			757,977.13	6,138,696.04	757,977.13
Mutual Benefit Life Insurance Co., Newark, N. J.....	1923.....			273,531.96	503,885.52	273,531.96
National Life Insurance Co., Montpelier, Vt.....	1922 to 1924, inclusive.....			419,075.63	419,075.63	419,075.63
New England Mutual Life Insurance Co., Boston, Mass.....	1924 to 1926, inclusive.....			365,972.09	569,132.07	365,972.09
New York Life Insurance Co., New York City.....	1922.....			139,180.49	1,426,349.77	139,180.49
Do.....	1924 to 1926.....			2,394,615.47	5,644,365.45	2,394,615.47
Northwestern Mutual Life Insurance Co., Milwaukee, Wis.....	1924 and 1925.....	11,057.36	238,011.63	742,473.25	1,857,867.10	742,473.25
Norton Co., Worcester, Mass.....	1917.....	113,307.19			1,816,208.26	249,008.99
O'Garra Coal Co., Chicago, Ill.....	1917 and 1918.....			255,899.59	504,069.12	369,206.78
Phillips, Waite, Tulsa, Okla.....	1926.....		250,225.09		253,458.82	250,225.09
Prudential Insurance Co. of America, Newark, N. J.....	1924.....			781,869.68	1,350,993.27	781,869.68
Rice & Hutchins (Inc.), Boston, Mass.....	1917, 1918, 1919.....	2,691.36		184,322.08	1,493,687.15	187,213.44
Sherwin Williams Co., Cleveland, Ohio.....	1922.....			141,671.95	216,641.38	141,671.95
State Mutual Life Assurance Co., Worcester, Mass.....	1923 and 1925.....			180,945.74	268,761.01	180,945.74
Staten Island Shipbuilding Co., Staten Island, N. Y.....	1918 and 1919.....	34,518.33	31,937.62 + 37,711.68	99,952.46	1,210,108.03	204,100.09
Tarsco Corporation, Pawtucket, R. I.....	1919.....			178,839.77	2,540,500.84	178,839.77
Total.....		169,196.31	1,440,594.27	7,386,967.90	47,201,190.71	8,996,761.48

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
Cleveland Twist Drill Co., Cleveland, Ohio-----	\$60,712.99	-----	\$3,130,137.16	\$4,607.11	<i>Per cent</i> 10.17	Special assessment (sec. 210, 1917 act, and secs. 327 and 328, 1918 act) and amortization.
Columbian National Life Insurance Co., Boston, Mass.-----	974.37	-----	55,750.75	24,249.63	56.12	Supreme court decision; insurance company (tax-exempt interest).
Connecticut Mutual Life Insurance Co., Hartford, Conn.-----	-----	-----	75,043.85	18,562.05	65.49	Do.
Crane Co., Chicago, Ill.-----	-----	-----	15,550,013.19	21,771.95	2.62	Miscellaneous (increase in pre-war net income and profit on sale of plant).
Crane, Frederick G., estate of, Dalton, Mass.-----	-----	-----	16,357.19	46,605.32	83.63	Miscellaneous (loss sustained from operation of a farm).
Equitable Life Insurance Co. of Iowa, Des Moines, Iowa.-----	-----	-----	316,991.78	8,781.43	20.08	Supreme Court decision; insurance company (tax-exempt interest).
Galloway Coal Co., Memphis, Tenn.-----	102,409.08	-----	318,206.96	21,723.84	36.76	Depreciation and depletion, increase in allowance for.
Marine Securities Co., Evanston, Ill.-----	1,361,367.30	-----	4,019,351.61	296,318.66	34.52	Amortization and special assessment.
Mutual Benefit Life Insurance Co., Newark, N. J.-----	-----	-----	230,353.56	67,197.67	54.28	Supreme Court decision; insurance company (tax-exempt interest).
National Life Insurance Co., Montpelier, Vt.-----	-----	-----	-----	106,761.85	-----	Do.
New England Mutual Life Insurance Co., Boston, Mass.-----	-----	-----	203,159.98	48,736.50	64.30	Do.
New York Life Insurance Co., New York City-----	-----	\$911,204.38	375,964.90	9,664.46	9.76	Do.
Do-----	-----	-----	3,249,749.98	240,084.68	42.42	Do.
Northwestern Mutual Life Insurance Co., Milwaukee, Wis.-----	-----	-----	1,115,363.85	112,332.10	39.96	Do.
Norton Co., Worcester, Mass.-----	1,963.19	-----	1,565,176.08	17,584.01	13.82	Depreciation and special assessment.
O'Gara Coal Co., Chicago, Ill.-----	-----	-----	134,862.34	131,301.96	73.25	Miscellaneous. (Elimination of excess profits taxes to trustee in bankruptcy—Supreme Court decision.)
Phillips, Waite, Tulsa, Okla.-----	-----	-----	3,293.73	12,178.01	98.72	Transfer of profit from 1926 to 1925.
Prudential Insurance Co. of America, Newark, N. J.-----	9,335.41	-----	559,788.18	144,043.33	58.56	Supreme Court decision; insurance company.
Rice & Hutchins (Inc.), Boston, Mass.-----	13,802.37	-----	1,292,671.34	97,143.00	13.46	Affiliation; exclusion of company.
Sherwin Williams Co., Cleveland, Ohio-----	-----	-----	74,969.43	65.39	65.39	Depreciation and inventory adjustment.
State Mutual Life Assurance Co., Worcester, Mass.-----	-----	-----	87,815.27	34,204.70	67.33	Supreme Court decision; insurance company (tax-exempt interest).
Staten Island Shipbuilding Co., Staten Island, N. Y.-----	142,131.33	-----	863,826.61	49,339.12	28.62	Change in method of reporting income.
Tarso Corporation, Pawtucket, R. I.-----	-----	-----	2,361,661.07	85,213.48	7.04	Change in accounting period.
Total-----	1,692,746.04	911,204.38	35,600,478.81	1,644,941.79	-----	-----

² Unadjusted, appeal pending.

¹ Includes excess collection of \$132.70 which was not assessed.

Distribution of above abatements, credits, and refunds in cases where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds
Galloway Coal Co., Memphis, Tenn.	1918, 1920, 1921, 1923, 1924, 1925			\$81,586.06
Patterson Transfer Co., Memphis, Tenn. ¹	1921			1,002.84
Harrisburg Big Muddy Coal Co., Chicago, Ill. ²	1917			9,695.75
Harrisburg Saline Collieries Co., Chicago, Ill. ²	1917			25,878.49
O'Garra Coal Co., Chicago, Ill. ²	1917, 1918	\$113,307.19		220,325.35
Atlas Shoe Co., Boston, Mass. ³	1917			2,433.91
Rice & Hutchins Cleveland Co., Cleveland, Ohio ³	1917, 1918			464.13
Rice & Hutchins (Inc.), Boston, Mass.	1917, 1918, 1919	2,691.36		188,679.43
Rice & Hutchins Baltimore Co., Baltimore, Md. ³	1917			2,614.62
Rice & Hutchins Atlanta Co., Atlanta, Ga. ³	1917			320.61
Rice & Hutchins Philadelphia Co. (Inc.), Philadelphia, Pa. ³	1917			728.99
Rice & Hutchins Chicago Co., Chicago, Ill. ³	1917			3,001.57
Rice & Hutchins New York Co., New York ³	1917			3,180.57
Rice & Hutchins St. Louis Shoe Co., St. Louis, Mo. ³	1917			1,861.20
Rice & Hutchins Cincinnati Co., Boston, Mass. ³	1917			1,237.05

¹ Subsidiary of Galloway Coal Co.

² Subsidiary of O'Garra Coal Co.

³ Subsidiary of Rice & Hutchins (Inc.).

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

NOVEMBER, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
Central Leather Co., New York	1919			\$743,890.02	\$3,520,486.60	\$743,890.02
Chicago Coated Board Co., New York	1920			100,827.05	831,742.00	100,827.05
H. & B. American Machine Co., South Attleboro, Mass.	1917 to 1920, inclusive		\$6,545.28	113,612.46	1,312,872.44	120,157.74
International Mercantile Marine Co., New York	1919 and 1920		1,229,315.91		1,229,315.91	1,229,315.91
Libby-Owens Sheet Glass Co., Toledo, Ohio ¹	1920			177,996.71	1,816,143.68	177,996.71
Middle States Oil Corporation, New York	1918 to 1920, inclusive	\$4,414,805.67	168,421.10		4,583,226.77	4,583,226.77
National Fuel Gas Co. and subsidiaries, New York	1913 to 1917, 1919 to 1921	70,702.59	241,168.71		996,923.47	311,871.37
Rosenberg Bros. & Co., San Francisco, Calif.	1920, 1921, and 1924	111,353.64	11,926.90	64,760.27	403,601.57	188,040.81
Woolworth, Frank W., estate of, New York	1919		113,625.29	162,022.48	275,647.77	275,647.77
Total		4,596,861.90	1,771,003.19	1,363,109.06	14,969,960.21	7,730,974.15

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refund or credit
Central Leather Co., New York.....	\$346,813.36		\$2,429,733.22	\$860,950.63	<i>Per cent</i> 30.98	Inventory adjustment.
Chicago Coated Board Co., New York.....			730,914.95	32,637.45	12.12	Special assessment (secs. 327 and 328, revenue act, 1918).
H. & B. American Machine Co., South Attleboro, Mass.....	58,929.86		1,133,784.84	21,587.18	13.64	Invested capital.
International Mercantile Marine Co., New York.....			1,638,146.97	23,315.13	100.00	Miscellaneous (credits for taxes paid to foreign countries). ¹
Libby-Owens Sheet Glass Co., Toledo, Ohio.....				33,952.79	9.22	Special assessment (secs. 327 and 328, revenue act, 1918).
Middle States Oil Corporation, New York.....					100.00	Affiliation and correction of overstated income resulting from defective accounting records (also depletion).
National Fuel Gas Co. and subsidiaries, New York.....		\$299.82	684,752.28	41,608.58	31.28	Depreciation, increase in allowance for.
Rosenberg Bros. & Co., San Francisco, Calif.....			215,566.76	29,259.52	46.59	Change in accounting period.
Woolworth, Frank W., estate of, New York.....				104,022.01	100.00	Estate tax (deduction in New York State transfer tax); Supreme Court decision.
Total	405,743.22	299.82	6,832,943.02	647,342.29		

¹ Includes excess collection of \$10,326.94 which was not assessed.

Distribution of above abatements, credits, and refunds where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds
Clarton Gas Co., Oil City, Pa. ¹	1913 to 1917, inclusive.....		\$2,907.19	
Iroquois Building Corporation, Buffalo, N. Y. ¹	1913 to 1916, inclusive.....		215.94	
Iroquois Natural Gas Co., Buffalo, N. Y. ¹	1912 to 1917, inclusive.....	\$11,510.04	26,726.99	
National Fuel Gas Co., New York.....	1913 to 1916, 1919 to 1921, inclusive.....	59,192.55	129,714.55	\$0.07
United Natural Gas Co., Oil City, Pa. ¹	1914 to 1917, inclusive.....		81,579.58	
Williams Natural Gas Co., Buffalo, N. Y. ¹	1914 and 1915.....		24.46	

¹ Subsidiaries of National Fuel Gas Co.

Refunds and credits reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928

DECEMBER, 1928

Name and address of taxpayer	Years involved	Abatements	Credits	Refunds	Original and additional assessments	Net over-assessments
Allen Property Custodian for trust No. 2975 (Schmidtische Heissdampf Gesellschaft), Washington, D. C.	1918, 1919, 1920, and 1924	\$2,213.77	\$153,653.52	\$556,345.23	\$720,674.55	\$712,212.52
Astor Waldorf, New York	1921 and 1922		22,990.34	135,950.58	1,201,860.96	312,660.76
Boston Store, Chicago, Ill.	1920 and 1922	153,719.84	137,287.96		936,318.74	137,287.96
Brooks, Peter C., Boston, Mass.	1919				153,951.99	87,515.73
Glinchfield Coal Corporation, Danle, Va.	1917			87,515.73	374,735.54	114,645.48
Glyde, William P., estate of, New York	1923			114,645.48	3,907,719.26	1,297,307.42
Donner Steel Co., Buffalo, N. Y.	1920			1,297,307.42	107,327.32	1,297,327.32
Durie Mills, Fall River, Mass.	1917			107,327.32	126,608.86	126,608.86
Eric R. R. Co., New York	1920			182,208.97	159,931.57	182,208.97
General Electric Co., Schenectady, N. Y.	1920 and 1921	19,834.27	355,371.91		692,892.61	375,206.18
Kenam, Graham (Mrs.), Wilmington, N. C.	1922 and 1923			122,056.54	4,861,704.46	122,056.54
Middle West Utilities Co. and subsidiaries, Chicago, Ill.	1918, 1919, and 1920			157,284.22	264,653.17	160,891.27
Nevada-California Electric Corporation, Denver, Colo.	1921, 1922, and 1924	3,607.05		77,055.74	191,918.80	77,055.74
New Cornelia Copper Co., Calumet, Mich.	1924			37,370.99	76,876.21	76,876.21
Norton Co., Worcester, Mass.	1918	194,505.57	39,505.22	185,541.48	3,501,280.27	748,528.63
Ohio Oil Co. and subsidiary, Findlay, Ohio	1916, 1917, and 1918		261,551.80			
Poind Coal Co. and subsidiaries, Pittsburgh, Pa.	1917, 1918, and 1919		872,723.82	985,414.24	8,351,981.62	1,858,138.06
Reid, Daniel G., estate of, New York	1925		25,960.41	319,172.48	907,963.50	339,132.89
Union Sulphur Co., New York	1919 and 1921			97,201.82	659,365.47	97,201.82
United Fruit Co., Boston, Mass.	1922		35,232.47	126,744.07	451,811.66	161,976.54
United States Steel Corporation and subsidiaries, New York	1917			153,278.08	2,057,827.50	153,278.08
				15,756,595.72	70,904,392.07	15,756,595.72
		373,880.50	2,011,207.23	20,619,625.57	100,517,233.81	23,004,713.30

Name and address of taxpayer	Previously allowed	Barred by statute	Final tax collected	Interest	Tax reduction	Principal causes for refunds of credits
Allen Property Custodian for trust No. 2975 (Schmidtsche Heissdampf Gesellschaft), Washington, D. C.	-----	-----	\$8,462.03	-----	<i>Per cent</i> 98.83	Miscellaneous; elimination of profit from sale of stock and interest reported on unpaid purchase price, which stock was not owned by taxpayer at time of seizure by Alien Property Custodian.
Astor Waldorf, New York	-----	-----	889,200.20	\$49,994.74	26.01	Miscellaneous; taxes paid to Great Britain on income received from sources within the United States.
Boston Store, Chicago, Ill.	-----	-----	799,030.78	20,069.64	14.66	Miscellaneous; allowance of deductions from income of real and personal property.
Brooks, Peter C., Boston, Mass. ¹	\$13,744.74	\$46.68	52,644.84	9,139.99	65.77	Estate tax (income of trust created by taxpayer not taxable to grantor).
Clinchfield Coal Corporation, Dante, Va.	196,630.62	-----	63,449.44	60,540.24	83.07	Invested capital (also elimination from income of stock dividends, depreciation and depletion allowances).
Clyde, William P., estate of, New York	-----	-----	2,610,411.84	107,623.20	33.20	Estate tax (gift held not to be in contemplation of death).
Donner Steel Co., Buffalo, N. Y.	-----	-----	-----	30,958.79	100.00	Depreciation, increase in allowance for (also losses sustained in abandonment of plant and equipment).
Durfee Mills, Fall River, Mass.	-----	-----	33,322.71	33,438.61	79.16	Miscellaneous; collection of taxes barred when payment was made.
Erie R. R. Co., New York	3,919.35	-----	416,764.29	76,630.73	30.87	Miscellaneous; excess compensation and interest for use of railroad properties during period of Federal control taxable only in year in which received.
General Electric Co., Schenectady, N. Y.	-----	-----	4,486,498.28	92,445.31	7.72	Affiliation inventory adjustment and depreciation.
Kenan, Graham (Mrs.), Wilmington, N. C.	-----	-----	-----	38,218.33	100.00	Estate tax (sec. 703, revenue act, 1928).
Middle West Utilities Co. and subsidiaries, Chicago, Ill.	75,087.62	-----	28,674.28	82,383.57	89.17	Depreciation and miscellaneous deductions.
Nevada-California Electric Corporation, Denver, Colo. ²	-----	-----	114,863.06	20,891.72	40.15	Depreciation, increase in allowance for.
New Cornelia Copper Co., Calumet, Mich.	-----	-----	-----	15,570.17	100.00	Miscellaneous; statutory net loss for 1922 applied against net income for 1924 (sec. 206, revenue act 1924).
Norton Co., Worcester, Mass.	-----	-----	2,752,751.64	55,444.07	2.14	Amortization (also special assessment).
Ohio Oil Co. and subsidiary, Findlay, Ohio	-----	-----	6,449,262.94	804,136.87	22.25	Invested capital (also depletion and depreciation).
Poland Coal Co. and subsidiaries, Pittsburgh, Pa.	215,445.18	44,580.62	333,385.43	153,895.98	61.08	Affiliation.
Reid, Daniel G., estate of, New York	-----	-----	562,163.65	-----	14.74	Estate tax (sec. 322, revenue act 1926).
Union Sulphur Co., New York	-----	-----	289,835.12	62,096.51	35.85	Miscellaneous; damages sustained on account of breach of contract.
United Fruit Co., Boston, Mass.	-----	-----	1,904,548.82	46,563.12	7.45	Miscellaneous; rise in foreign exchange eliminated from amount reported in original return.
United States Steel Corporation and subsidiaries, New York.	37,387,604.95	-----	17,760,191.40	10,099,765.42	74.95	Invested capital.
	37,802,432.46	44,627.30	39,575,460.75	11,859,507.01	-----	

¹ Includes excess collection of \$9,953.78 which was not assessed.² Includes excess collection of \$156.73 which was not assessed.³ Unadjusted, deficiency.

Distribution of above abatements, credits, and refunds in cases where apportionment has been made to members of an affiliated group

Name and address of taxpayer	Years involved	Abatement	Credit	Refund
Central Power Co., Grand Island, Nebr. ¹	1919			
Hamilton Utilities Co., Springfield, Ill. ¹	1918, 1919	\$1,610.71		\$592.30
Hoopeston Gas & Electric Co., Springfield, Ill. ¹	1918, 1919			4,449.42
Interstate Public Service Co., Indianapolis, Ind. ¹	1918			752.94
Kearney Water & Electric Powers Co., Kearney, Nebr. ¹	1919	1,200.00		
Louisville & Northern Rwy. & Light Co., Indianapolis, Ind. ¹	1918			3,255.20
Middle West Utilities Co., Chicago, Ill.	1918 to 1920, inclusive			137,332.15
Midway Gas Co., Kearney, Nebr. ¹	1919	240.00		
North West Utilities Co., Chicago, Ill. ¹	1919			10,902.21
South Construction Co., New Albany, Ind. ¹	1919	556.34		
Ohio Oil Co., Findlay, Ohio	1916 to 1918, inclusive		\$869,499.40	985,414.24
Mid-Kansas Oil & Gas Co., Findlay, Ohio ²	1916		3,224.42	
Lowber Gas Coal Co., Pittsburgh, Pa. ³	1917 to 1919, inclusive			125,517.25
Orient Coke Co., Pittsburgh, Pa. ³	1917 to 1919, inclusive			187,655.23
Poland Coal Co., Pittsburgh, Pa.	1917		25,960.41	
Carnegie Steel Co. of New Jersey, New York ⁴	1917			15,752,442.55
United States Steel Corporation, New York	1917			4,183.17

¹ Subsidiary of Middle West Utilities Co.

² Subsidiary of Ohio Oil Co.

³ Subsidiary of Poland Coal Co.

⁴ Subsidiary of Carnegie Steel Co. of New Jersey.

PART II

PART II

GENERAL SURVEY OF OVERASSESSMENTS IN EXCESS OF \$75,000

The total refunds, shown in detail in Part I, amount to \$53,735,-063.56; the total credits amount to \$17,944,683.20; and the total abatements in connection with the same cases amount to \$12,416,-838.85. The total overassessments reported in the period June 1 to December 31, 1928, amount to the sum of the above three items, or to \$84,096,585.61. On these overassessments the sum of \$22,473,308.38 was allowed in interest, making a grand total of overassessments and interest of \$106,569,893.99.

It is important to note that the rate of overassessment allowed plus interest for the 7-month period June 1 to December 31, 1928, is \$15,224,270 per month. For the 14-month period March 1, 1927, to April 24, 1928, the corresponding rate was \$8,402,147 per month. There has been an increase of over 80 per cent, therefore, in the rate of these allowances since our last report. This does not necessarily represent a more liberal policy in regard to credits and refunds, for there has been a strong drive made by the bureau for the purpose of settling old cases in the past year.

Another point which should be observed is the fact that 77 per cent of these refunds and credits involve taxable years prior to 1922. When these old years are finally closed a very material decrease in refunds and credits should be expected.

A complete summary of Part I is now shown, including a classification of overassessments in re principal cause, which is important for purposes of discussion:

Summary of overassessment cases reported to the Joint Committee on Internal Revenue Taxation by the Commissioner of Internal Revenue under the provisions of section 710 of the revenue act of 1928, for the 7-month period from June 1 to December 31, 1928. Total cases, 162; monthly average, 23

Total original and additional assessments	\$372, 129, 773. 65
Final tax collected	\$238, 885, 403. 24
Previous allowances	47, 529, 037. 72
	<hr/> 286, 414, 440. 96
Overassessments	85, 715, 332. 69
Barred by statute	1, 618, 747. 08
	<hr/> Net overassessments
	<hr/> \$84, 096, 585. 61
Composed of:	
Refunds	53, 735, 063. 56
Credits	17, 944, 683. 20
Abatements	12, 416, 838. 85
	<hr/> 84, 096, 585. 61
Interest paid on overassessments	22, 473, 308. 38
Total of overassessments and interest	<hr/> 106, 569, 893. 99
Reduction in total assessments by overassessments reported (per cent)	22. 60
Average percentage of interest paid on overassessments	26. 72

Classification of overassessments in re principal cause

Number of cases	Principal cause	Overassessments	Interest cost	Total overassessments and interest	Per cent of overassessment to total overassessments
5	Invested capital.....	\$20,597,900.03	\$12,161,358.09	\$32,759,258.12	24.49
23	Supreme Court decision; insurance companies.....	10,829,673.60	1,424,288.15	12,253,961.75	12.88
12	Amortization.....	8,015,390.44	1,624,130.42	9,639,520.86	9.53
20	Special assessment.....	7,567,617.34	2,308,308.71	9,875,926.05	9.00
8	Affiliation.....	6,582,397.42	524,597.09	7,106,994.51	7.83
6	Inventory adjustments.....	4,008,671.25	563,822.30	4,572,493.55	4.77
19	Depreciation.....	3,866,865.82	1,008,757.66	4,875,623.48	4.60
12	Estate tax.....	3,032,323.70	478,152.65	3,510,476.35	3.61
4	Reallocation of income.....	2,361,197.61	131,869.74	2,493,067.35	2.81
2	Foreign taxes.....	1,541,976.67	49,994.74	1,591,971.41	1.83
6	Gift tax.....	1,082,985.26	216,535.43	1,299,520.69	1.29
6	Change in accounting period.....	1,054,151.32	183,650.76	1,237,802.08	1.25
3	Valuations.....	834,509.00	119,069.57	953,578.57	.99
2	Transfer tax.....	657,306.09	146,631.81	803,937.90	.78
3	Change in method of reporting income.....	423,272.00	92,774.79	516,046.79	.51
1	Depletion.....	121,820.25	63,601.92	185,422.17	.14
2	Loss of useful value.....	110,414.81	45,803.14	156,217.95	.13
29	Miscellaneous.....	11,408,113.00	1,329,961.41	12,738,074.41	13.56
162	Grand total.....	84,096,585.61	22,473,308.38	106,569,893.99	100.00

On account of the very large refund of over \$15,000,000 to the United States Steel Corporation and the refunds to the insurance companies the above classification of refunds is not as representative or as instructive as was the case in our former reports. The refunds only cover the period June 1, 1928, to December 31, 1928, also, which is a rather short period to use for analysis.

It has been thought better, therefore, to combine the refunds reported under the urgent deficiency bill with the refunds under the 1928 act before making an analysis of the results. This gives us a period from March 1, 1927, to December 31, 1928, exclusive of the period April 25, 1928, to May 31, 1928, during which refunds were not required to be reported to this committee. This will give a 21-month period. The classification of overassessments for this 21-month period is as follows:

Classification of overassessments in re principal cause (21-month period March 1, 1927, to April 24, 1928, and June 1, 1928, to December 31, 1928)

Number of cases	Principal cause	Overassessment	Interest cost	Total over-assessment and interest	Per cent of over-assessment to total overassessments
30	Invested capital.....	\$32,584,367.74	\$14,295,568.11	\$46,879,935.85	17.93
78	Special assessment.....	26,008,452.53	6,681,081.44	32,689,533.97	14.31
33	Amortization.....	18,196,096.81	3,929,518.87	22,125,615.68	10.01
50	Estate tax.....	13,945,437.98	1,959,576.11	15,905,014.09	7.67
47	Affiliation.....	13,785,665.20	2,029,587.59	15,815,252.79	7.59
53	Depreciation.....	11,338,538.79	2,518,499.11	13,857,037.90	6.24
23	Insurance companies (Supreme Court decision).....	10,829,673.60	1,424,288.15	12,253,961.75	5.96
38	Inventory adjustments.....	10,396,478.67	1,783,273.20	12,179,751.87	5.72
20	Valuations.....	3,298,584.27	469,931.34	3,768,515.61	1.81
4	Reallocation of income.....	2,361,197.61	131,869.74	2,493,067.35	1.30
8	Obsolescence.....	2,089,211.46	302,450.05	2,391,661.51	1.15
9	Depletion.....	1,948,075.81	547,056.72	2,495,132.53	1.07
10	Gift tax.....	1,928,884.76	291,355.57	2,220,240.33	1.06
4	Foreign taxes.....	1,755,539.50	70,421.04	1,825,960.54	.97
6	Transfer tax.....	1,437,776.34	417,265.22	1,855,041.56	.79
6	Change in accounting period.....	1,054,151.32	183,650.76	1,237,802.08	.68
5	Miscellaneous court judgments.....	1,009,187.11	286,401.41	1,295,588.52	.66
3	Change in method of reporting income.....	423,272.00	92,774.79	516,046.79	.23
3	Capital stock tax.....	390,163.39	85,426.05	475,589.44	.21
1	Loss of useful value.....	110,414.81	45,803.14	156,217.95	.06
108	Miscellaneous.....	26,860,677.99	3,872,137.62	30,732,815.61	14.78
123	Interest recomputation (Supreme Court decision).....	-----	1,030,165.71	1,030,165.71	-----
662	Total.....	181,751,847.69	42,448,101.74	224,199,949.43	100.00

This last classification table appears worthy of study, for some important conclusions can be arrived at from its analysis.

First. It can be seen that three provisions are responsible for over 42 per cent of all overassessments, and that these three provisions are now obsolete as far as our present revenue act is concerned, for they have not been applicable to taxable years since 1921. It should also be noted that two of the provisions are relief provisions. The above is shown by the following figures:

Per cent of overassessment to total overassessments

Principal cause:	
Invested capital.....	17.93
Special assessment.....	14.31
Amortization.....	10.01
Total.....	42.25

Second. If the principal cause be examined to determine those in which *valuations* are directly or indirectly involved, it will be astonishing to find that over 33 per cent of the total of the overassessments involve this judgment question in whole or in part. The figures below show this:

Per cent of overassessment to total overassessments

Principal cause:	
Amortization (value in use).....	10.01
Estate tax (value at date of death).....	7.67
Depreciation (Mar. 1, 1913, value).....	6.24
Inventory adjustment (market value).....	5.72
Valuations (gain or loss, etc.).....	1.81
Obsolescence (decrease in value).....	1.15
Depletion (Mar. 1 value, discovery value).....	1.07
Loss of useful value (scrap value).....	.06
Total.....	33.73

Third. If all provisions not found in our present revenue act are eliminated, it will be found that 42 per cent of our present troubles probably lie with these same judgment questions which arise in valuation of estates, in depreciation, in inventory values, in valuations for gain or loss, in obsolescence, in depletion, and in the determination of the loss of useful value.

It seems fair to conclude from the above brief analysis that refunds and credits will be materially reduced when the taxable years prior to 1922 are finally closed. It is also apparent that if valuations could be partially eliminated or the methods used made more definite, then even our present troubles could be materially reduced.

It has seemed worth while to compare the percentage of the total income and estate taxes returned by each State for 1926 with the percentage of the total overassessments allowed the taxpayers from each of the States for the 21-month period March 1, 1927, to April 24, 1928, and June 1, 1928, to December 31, 1928. This comparison follows:

Comparison of taxes paid by States and refunds, credits, and abatements, by States, in percentage

State or Territory	Percentage of income and estate taxes returned to total tax returned (1926) ¹	Percentage of over-assessments allowed on income and estate taxes to total over-assessment, 21-month period Mar. 1, 1927, to Apr. 24, 1928, and June 1, 1928, to Dec. 31, 1928
Alabama.....	0.38	0.00
Arizona.....	.08	.00
Arkansas.....	.18	.06
California.....	5.23	2.37
Colorado.....	.54	.84
Connecticut.....	1.51	.71
Delaware.....	.80	.76
District of Columbia.....	.77	1.01
Florida.....	1.09	.07
Georgia.....	.53	.20
Hawaii.....	.23	.00
Idaho.....	.05	.00
Illinois.....	9.11	5.26
Indiana.....	1.24	.91
Iowa.....	.48	.04
Kansas.....	.99	.00
Kentucky.....	.65	1.36
Louisiana.....	.57	.12
Maine.....	.37	.00
Maryland.....	1.38	.63
Massachusetts.....	4.42	6.71
Michigan.....	6.05	2.12
Minnesota.....	1.15	.52
Mississippi.....	.10	.00
Missouri.....	2.41	1.78
Montana.....	.10	.11
Nebraska.....	.23	.22
Nevada.....	.03	.00
New Hampshire.....	.12	.00
New Jersey.....	3.89	5.84
New Mexico.....	.03	.00
New York.....	30.63	46.23
North Carolina.....	.83	4.31
North Dakota.....	.03	.00
Ohio.....	5.07	4.13

¹ Estate-tax returns filed in 1927 are used in connection with income tax returns for 1926, since 1927 returns roughly approximate taxes on estates of 1926 decedents.

*Comparison of taxes paid by States and refunds, credits, and abatements, by States,
in percentage—Continued*

State or Territory	Percentage of income and estate taxes returned to total tax returned (1926)	Percentage of over- assessments allowed on income and estate taxes to total over- assessment, 21-month period Mar. 1, 1927, to Apr. 24, 1928, and June 1, 1928, to Dec. 31, 1928
Oklahoma.....	0.92	0.27
Oregon.....	.26	.05
Pennsylvania.....	10.24	8.14
Rhode Island.....	.56	.83
South Carolina.....	.18	.06
South Dakota.....	.02	.00
Tennessee.....	.59	.27
Texas.....	1.94	.78
Utah.....	.14	.00
Vermont.....	.11	.45
Virginia.....	1.04	.37
Washington ²51	.14
West Virginia.....	.59	.45
Wisconsin.....	1.59	1.88
Wyoming.....	.04	.00
Total.....	100.00	100.00

² Alaska included in Washington.

From the above list it can be seen that while New York paid 30.63 per cent of the taxes in 1926, it received 46.23 per cent of all the refunds reported to the joint committee.

In the same way, Massachusetts paid 4.42 per cent of the taxes and received 6.71 per cent of the refunds; New Jersey paid 3.89 per cent of the taxes and received 5.84 per cent of the refunds; North Carolina paid 0.83 per cent of the taxes and received 4.31 per cent of the refunds; and the only other States or Territories receiving a higher percentage of refunds than of taxes paid are Colorado, District of Columbia, Kentucky, Montana, Rhode Island, Vermont, and Wisconsin.

While the above data are interesting, it appears that conclusions should not be drawn unless all refunds should be included in the study rather than just those over \$75,000. However, it is fair to raise this question:

Do the disproportionately large refunds received by the States of New York, Massachusetts, New Jersey, and North Carolina occur because the taxpayers in those States make a larger number of mistakes or do they occur because the taxpayers have better lawyers in those States?

It can not be doubted that in the matter of tax adjustments, taxpayers who live east of the Mississippi are at a considerable advantage because they can contest these taxes with less expense before the bureau in Washington.

In concluding this part of the report it seems proper to sum up the principal conclusions which can be drawn from the analysis made, as follows:

1. Eighty-three per cent of all refunds reported to the joint committee in a 21-month period involve the excess-profits tax years prior to 1922.

2. Forty-two per cent of all refunds are due to provisions no longer found in our revenue act.

3. The present provisions which seem to be most troublesome from the standpoint of refunds are those which involve valuations of tangible and intangible property.

4. The decision of the Supreme Court of the United States in the National Life Insurance Co. case materially lowers even the very small tax imposed on life-insurance companies by the revenue act. It will cost the Government approximately \$35,000,000 in refunds and \$8,000,000 per annum for the future.

Special attention is directed to the supplement immediately following, which contains valuable statistics prepared on refunds by the Treasury Department. The point of view taken is somewhat different, and no attempt has been made to reconcile the two compilations.

SUPPLEMENT TO PART II

ANALYSIS OF OVERASSESSMENTS PREPARED BY THE TREASURY DEPARTMENT

LETTER OF TRANSMITTAL

TREASURY DEPARTMENT,
Washington, June 17, 1929.

MY DEAR MR. CHAIRMAN: In accordance with the decision of the joint committee at its meeting on June 8, I am transmitting herewith an analysis of the overassessments reported to the committee prior to January 18, 1929. Several months ago the Treasury directed that this analysis be prepared and kept current, primarily for our use and for the use of your committee. It is believed that this report will be of interest to your committee and a useful supplement to the statistics and discussion found in Part II of the report of your division of investigation recently submitted to you.

Every one familiar with the revenue-collection system recognizes that refunds and credits are obviously a necessary incident to the administration of our tax laws. It is believed, however, that a reasonably accurate and detailed analysis of the specific reasons has not been available heretofore. In this connection it is particularly interesting to point out that the accompanying report shows that 85.20 per cent of the overassessments are attributable to clerical or bookkeeping adjustments or to causes beyond the control of either the Treasury or the taxpayer—that is, to adjustments after the payment of tax based upon causes which could not fairly be considered prior to the payment, such causes being:

	Per cent
Court and board decisions.....	1 28. 07
Relief under special assessment.....	10. 50
Retroactive legislative.....	2 7. 01
Amortization.....	5. 17
Changes in invested capital.....	8. 50
Depreciation.....	3. 80
Depletion.....	1. 60
Shifts of income.....	8. 08
Duplicate assessments.....	6. 52
Inventories.....	3. 52
Changes in affiliation.....	2. 43
Total.....	85. 20

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

Hon. WILLIS C. HAWLEY,
*Chairman Joint Committee on Internal Revenue Taxation,
House of Representatives.*

¹ This figure does not include overassessments due to stipulated board decisions.

² This figure includes amortization allowances under section 1209, revenue act of 1926.

ANALYSIS OF OVERASSESSMENTS

The following report is intended to cover the causes resulting in those overassessments which have been submitted to the Joint Committee on Internal Revenue Taxation pursuant to the provisions of the urgent deficiency bill approved February 28, 1927, and the provisions of section 710 of the revenue act of 1928. The report includes all cases except those pending with the joint committee on January 18, 1929.

The number of income and profits tax cases examined in connection with the present report was 591, while the number of miscellaneous tax cases examined was 61. It sometimes happened that more than one report was submitted to the joint committee in the same case, covering different years or covering a supplemental overassessment for the same year. For this reason there is some discrepancy between the number of cases above referred to and the number of reports in such cases previously submitted to the joint committee.

In many of the cases overassessments were approved and issued prior to the urgent deficiency act of February 28, 1927, then after the passage of such act supplemental certificates in the same cases were considered and made the subject of reports to the joint committee. More as a matter of general interest a check was made of the cases to determine the amount of the original assessments as per the original returns, the amount of the additional assessments, and the amount of the overassessments. The object of this check was to find the extent to which the overassessments covered the original taxes assessed. As a result of this check it was found that the total original tax assessed amounted to \$839,749,667.30, that the total additional tax amounted to \$122,157,067.92, and that the total overassessments amounted to \$238,908,750.92. The total overassessments thus exceeded the total additional assessments by \$116,751,683, so that the original tax was overassessed by the latter amount which represents 13.9 per cent of the original tax.

Another comparison may be made by deducting from the figures above set out the amounts of overassessments due to court decisions, board decisions, specific legislation, and duplicate assessments, which amounted to \$35,017,557.18, \$21,769,260.14, \$8,922,619.88, and \$11,737,630.27, respectively, or a total of \$77,447,067.47. Deducting the latter figure from \$116,751,683 leaves \$39,304,615.53, which is 4.6 per cent of the original tax. Overassessments due to shifts of income amounted to \$24,854,767.88, while additional taxes resulting from such shifts amounted to \$27,911,192.82. The figure \$8,922,619.88 is conservatively stated, since it does not include overassessments due to the retroactive effect of section 1209 of the revenue act of 1926, which validated a great number of amortization claims otherwise outlawed under the board's decision in the case of Stauffer Chemical Co. (2 B. T. A. 841). Also the figure does not include overassessments allowable because of other retroactive provisions which validated claims which would otherwise have been outlawed. (See sec. 252 of the 1918 and 1921 acts as amended by the acts of March 4, 1923, and March 13, 1924; also 281 (e) of the 1924 act and 284 (g) of the 1926 act.) It is known that overassessments due to these retroactive provisions amount to a very substantial sum, but

due to lack of time for compiling the present report a check as to the amount has not been made.

It is believed that it may be conservatively stated that all overassessments in the cases now under consideration in excess of the additional taxes in the same cases may be attributed to such elementary and unavoidable reasons as court and board decisions, specific legislation, duplicate assessments, and shifts of income, which shifts produced more deficiencies than overassessments.

Included in the above comparisons, as well as in those which follow, is the United States Steel case for the year 1917. The original tax, additional tax, and overassessments of this company for the year 1917 were approximately \$200,000,000, \$17,700,000, and \$44,000,000, respectively.

Aside from the check above described the cases were analyzed with a view toward determining the principal causes of those overassessments which were considered after the urgent deficiency act of February 28, 1927, and after the passage of section 710 of the revenue act of 1928 and which were specifically made the subject of reports to the joint committee on internal revenue taxation. (Although the prior overassessments were reviewed in connection with subsequent overassessments they are not actually explained in detail in the reports to the joint committee.) In making this check the following plan was decided upon as giving the best cross-section of the matter:

It was decided to find first the amount of the *overassessments* submitted to the joint committee which were due to board decisions, court decisions, specific legislation, special assessment, duplicate assessments and "other causes." "Other causes" were in turn classified into depreciation, depletion, obsolescence and loss of useful value, inventories, changes in affiliation, losses and bad-debt deductions, invested capital adjustments, amortization, shifts of income, and miscellaneous. The amounts of overassessments caused by shifts of income to other years or other taxpayers due to all "other causes" was also listed as well as the additional taxes collected in other years from the same taxpayer or other taxpayers as a result of such shifts of income. The overassessments caused by shifts of income amounted to \$24,854,767.88 while the additional taxes resulting from such shifts amounted to \$27,911,192.82. The latter figure is conservative since in many cases the amount could not be determined in the time available and nothing was listed although it was known that additional taxes had resulted.

It was decided that the most equitable basis on which to determine the amount of overassessments due to the above causes was to apportion the total overassessments among the different causes on the basis of the ratio which the reduction in income due to each cause bore to the total reduction in income or increase in capital and this was done. A similar basis was used in miscellaneous taxes. When the amounts of the overassessments due to each cause were found in this manner the ratio of these amounts to total overassessments was then determined. It was then assumed that the *refunds*, *credits* and *abate-ments* were made in the same ratios except that all overassessments due to duplicate assessments and jeopardy assessments were applied to abatements unless it appeared that they had been applied to credits

or refunds. The following is a summary of the results obtained by this system, when applied to income and miscellaneous tax cases:

Classification	Refund	Amount of abatement	Credit	Total	Per cent
Court decisions.....	\$29,984,396.94	\$2,584,269.35	\$2,448,890.89	\$35,017,557.18	19.44
B. T. A. decisions.....	11,083,553.45	5,531,396.64	5,154,310.05	21,769,260.14	12.08
Specific legislation.....	5,245,523.36	2,680,249.12	993,847.40	8,922,619.88	4.95
Special assessment.....	13,582,132.76	1,844,222.07	3,494,309.01	18,920,663.84	10.50
Duplicate assessments.....	969,400.94	8,582,214.45	2,186,014.88	11,737,630.27	6.52
Other causes.....	49,224,393.45	14,214,935.35	20,339,977.99	83,779,306.79	46.51
Total.....	110,092,400.90	35,437,286.98	34,617,350.22	180,147,038.10	100.00

Analysis of classification, other causes

Item	Refund	Abatement	Credit	Total	Per cent
Depreciation.....	\$3,975,443.03	\$1,188,479.85	\$1,734,419.66	\$6,898,342.54	8.234
Depletion.....	1,667,547.12	498,522.09	727,523.07	2,893,592.28	3.454
Obsolescence.....	917,950.00	274,426.04	400,486.32	1,592,862.36	1.901
Inventory changes.....	3,658,669.02	1,093,778.58	1,596,216.43	6,348,664.03	7.578
Affiliation changes.....	2,526,321.14	755,257.15	1,102,191.89	4,383,770.18	5.233
Losses.....	830,004.45	248,134.25	362,117.14	1,440,255.84	1.719
Invested capital.....	8,832,342.01	2,640,475.66	3,853,403.91	15,326,221.58	18.294
Amortization.....	7,502,735.83	2,242,982.82	3,273,318.85	13,019,037.50	15.540
Shifts of income.....	8,393,870.72	2,509,392.34	3,662,106.18	14,565,369.24	17.385
Miscellaneous.....	10,919,510.13	2,763,486.57	3,628,194.54	17,311,191.24	20.662
Total.....	49,224,393.45	14,214,935.35	20,339,977.99	83,779,306.79	100.00

The adjustments classified under "other causes" all pertain to matters not covered by board and court decisions and matters not specifically classified, although some of the same type of adjustments in other cases may fall under the specific classifications. For example, some of the invested capital adjustments would be reported under the board's decision in the Regal Shoe case (1 B. T. A. 896), while other invested capital adjustments not affected by this or other decisions would be reported under the subheading "invested capital" under "other adjustments."

The exhibits attached to this report contain a list of board and court decisions with the amounts of refund, credit, and abatement due to each.

There seems to be no doubt but that the amounts of overassessments attributed to board and court decisions are conservatively stated. One reason for this is that due to the limited time available in making the present check all adjustments (particularly those pertaining to invested capital and those which caused overassessments prior to the overassessments submitted to the joint committee) could not be analyzed in the light of all board and court decisions. There was not sufficient time available to call out the closed files in the cases which also prevented a more detailed check. The adjustments classified under board and court decisions are ones which could be so classified practically at the first reading. Another reason why this classification is conservatively stated is that there are many board and court decisions *supporting* the bureau regulations and rulings and the overassessments falling within this class are not reported as being due to such decisions.

The following examples illustrate the classification as between board and court decisions and "other causes." The board has sustained article 143, Regulations 45, with respect to loss of useful value (Automatic Transportation Co., 3 B. T. A. 505; Sheridan Coal Co., 4 B. T. A. 563). The board has sustained article 161, Regulations 45, pertaining to obsolescence in the case of Kilby Car & Foundry Co. *v.* Commissioner (4 B. T. A. 1294). In the case of L. S. Donaldson Co. (Inc.) (12 B. T. A. 271) the board has sustained the bureau rulings published as L. O. 1108, C. B. 111-1, page 412, and S. M. 3384, C. B. IV-1, page 277, which rulings treat dealings between affiliated companies prior to January 1, 1917, as dealings between separate companies. These and other similar rulings sustained by the board and the courts had a material effect in a number of cases. In a negative sense at least overassessments due to these causes could be attributed to board decisions, since if the regulations and rulings had been overruled the overassessments would not have been allowed, but since the adjustments were allowable under regulations and rulings which were not changed, they have not been classed as attributable to board decisions.

Again the board and the courts have adopted the bureau's inventory regulations with respect to the right of the taxpayer to report inventories on a cost or cost or market whichever is lower basis; also the board allows amortization, depletion, depreciation, affiliation of companies, and the like. Consequently, if the matter of placing overassessments due to board and court decisions were carried far enough, practically every allowance could be attributed to such causes. As will be later indicated, the board has also sustained practically all, if not all, of the bureau's fundamental ideas of special assessment as expressed in L. O. 1109, C. B. 1-2, page 253, and other rulings, so that in a sense the present special assessment allowances could be attributed to board decisions. However, they have not been so classified except in a very few instances where the particular case under review had been before the board.

It should also be mentioned that in a number of cases overassessments were submitted to the Joint Committee as a result of the settlement of litigation in those particular cases. In the class of cases here referred to the taxpayer signed an order of dismissal of the litigation which was deposited in escrow with the Department of Justice, the same to be filed with the court upon the issuance of an overassessment in the amount specified. Overassessments in such cases as these are not in the present report classed as being attributable to court decisions. There is another closely related type of case where, instead of depositing the agreement in escrow pending the issuance of the certificate of overassessment, the taxpayer and the Government stipulated the amount of the judgment and after review of such stipulation the board entered a judgment. Since overassessments in these cases are based on an order of the board, such overassessments have been classed as being attributable to board decisions "in the instant case." Again in some of the cases covered in the present report it is found that there had been a court or board order covering adjustments for one year which also affected adjustments for other years of the same taxpayer. Overassessments for the other years so far as affected by the court or board decisions have been attributed to such decisions.

Likewise an attempt has been made to keep the overassessment due to specific legislation at a minimum. For example, as a result of the board's decision in the case of Stauffer Chemical Co. (2 B.T. A. 41), it was found that a great many claims for amortization were outlawed. A few months later Congress cured practically all these outlawed claims by section 1209 of the revenue act of 1926. A great many of the amortization allowances covered in the present report could be attributed to this retroactive legislation but since claims covering such allowances would have been allowable under the bureau's interpretation of the prior acts had it not been for the board decision, allowances under such claims have not been classified as due to specific legislation. The overassessments brought within the classification of specific legislation pertain primarily to legislation affecting rates of tax retroactively, installment sales (of which very few are covered in the present report), section 703 of the revenue act of 1928, section 254 (c) of the revenue act of 1926, and net losses. Overassessments due to duplicate assessments are self-explanatory.

Generally speaking, the overassessments covered in the present report are caused primarily by the following: (1) in doubtful matters of statutory construction the taxpayers did not place the same interpretation as did the department on various provisions of the acts; (2) even if their interpretation was the same as that of the department they could not determine valuations and gather other data necessary to compute the correct amount of tax liability until after their returns were filed; (3) the departmental interpretations of the acts were later changed either on the initiative of the department or because of court or board decisions; (4) retroactive legislation; and (5) failure of the taxpayers to follow the plain provisions of the acts.

The first edition of Regulations 45 pertaining to the revenue act of 1918 was not promulgated until April, 1919. Many taxpayers had already filed their returns and although others secured extensions of time for filing for a few months, an examination of the cases shows that the meaning of many provisions of the act and the regulations was not well understood. Regulations 62 pertaining to the 1921 act were also not promulgated until February, 1922. The following are examples of some of the difficulties noted:

A taxpayer knew that it was entitled to depreciation and depletion based on the March 1, 1913, value of certain assets, but through lack of time necessary to determine values as of that date based depreciation or depletion on cost or on estimated March 1, 1913, value knowing that correct values would have to be later determined. Again a taxpayer deducted a lump sum for depreciation, merely estimating the amount thereof, but later made a segregation of assets and applied more scientific rates thereto based on the life thereof and the extent to which the depreciable assets were actually used during the particular taxable year under consideration. Values in connection with discovery depletion also often required time for determination extending beyond the time when returns were required to be filed.

A taxpayer probably knew that the act provided for a reasonable allowance for amortization of facilities acquired for war purposes but whether it was of the class entitled to such an allowance and how the allowance was to be determined was probably not known at the time returns were filed or even if known the detailed data required to sup-

port the allowance had to be gathered later. The revenue acts of 1918 and 1921 (Sec. 234 (a) (8)) contemplated these difficulties and provided that a taxpayer could request or the commissioner on his own initiative could reexamine the returns and other data and make a redetermination of amortization up to March 3, 1924. The allowance for amortization was, generally speaking, based on the difference between cost and sale or salvage value or postwar replacement costs, or, on a comparison of capacity with postwar value in use in order to determine the remaining usefulness of the asset. Necessarily most of these comparisons could not be made until after the returns were filed with the result that a revision of the amortization deduction taken on the return was nearly always necessary.

During the war period many taxpayers entered into contracts with various branches of the Government and war agencies, particularly the War and Navy Departments, Shipping Board, and the Railroad Administration. After the war ended settlements under these contracts were necessary and tax liability could not be determined until after such settlements were made. Settlement of tax liability in many oil cases was also delayed due to the impoundment of funds growing out of the President's withdrawal order of 1909, subsequent litigation in connection therewith, and settlement under the leasing act of 1920. Some of the difficulties encountered in this respect are covered in L. O. 1110, C. B. II-1, page 104, and G. C. M. 1505, C. B. VI-1, page 208. Various taxpayers also had difficulty in determining where they stood with respect to their foreign accounts following the war period. Furthermore, during the war period taxpayers were encouraged by the Government to pay their taxes and settle doubtful points afterward since the Government needed the money. An example of this is found in section 1009 of the 1917 act and T. D. 2622 interpreting the same, which gave taxpayers a discount of 3 per cent on payments made within four and one-half months after the close of the taxable year.

Congress has from time to time since the passage of the 1918 act passed legislation extending the time within which companies could file claims for refund or credit, in cases where they had previously filed waivers. Compare section 252 of the 1918 and 1921 acts as amended by acts of March 4, 1923 and March 13, 1924—281 (e), 1924 act, 284 (g) 1926 act. These provisions of the various acts have revived or made possible the filing of many valid claims and consequently made possible many refunds and credits which would otherwise have been outlawed. Overassessments which have been made possible only because of these provisions belong strictly under the classification of specific legislation. However, an investigation in this respect would have made necessary the calling out of the complete files including all correspondence in the cases recently examined. This probably could not have been done and an intelligent examination made under one month's time and the examination may have taken longer, so for the purpose of the report no part of the overassessments due to this type of legislation has been reported as being due to specific legislation.

Sections 327 and 328 also provided for relief in taxes in certain cases if a comparison with representative concerns showed that the taxpayer was entitled to such relief but the classes of taxpayers entitled to the benefits of these sections were not made clear until

later interpretations of the sections were published. Again, even if the taxpayer knew that it was entitled to relief it had no means of knowing the amount thereof since the rates of tax paid by its competitors were not usually available to it. The average taxpayer computed and paid its tax and then filed a claim asking for the benefit of the relief provision where it thought that it might be entitled to such a benefit.

Section 240 provided that companies which were affiliated within the meaning of the section should file a consolidated return. Much confusion existed as to which companies were affiliated within the meaning of the statute and as to how the consolidated income and invested capital were to be determined even if they were affiliated.

There was also confusion in determining the amount of gain or loss on disposition of assets both from a valuation point of view and because March 1, 1913, values figured in the basis to be used.

Although the net loss provisions of the 1918 and 1921 acts (sec. 204) were fairly clear they were often misconstrued and many taxpayers neglected to take advantage of them altogether.

In reporting inventories many taxpayers did not follow the provisions set forth in the bureau regulations. Some of the methods used by the taxpayers which were not approved by the bureau regulations were the deductions of reserves for price changes; the deduction of an estimated depreciation in value of inventories; the valuation of part of the inventory on a cost basis and another part at cost or market whichever was lower basis, although the value of both parts of the inventory may have been greater or less than cost, the valuation of inventories at nominal prices or at a constant price and the inclusion in inventories of stock in transit, title to which was not in the taxpayer. Such practices as these are contrary to bureau regulations 1581 to 1588, Regulations 45 and 62.

There was confusion under the 1918 and 1921 acts as to whether the estate or the beneficiary should deduct inheritance or death taxes paid to the various States and also as to the correct manner of making returns in States having community property rights.

A taxpayer made his return on different periods of time from that on which the books were kept or made returns on a cash basis when the books were on an accrual basis contrary to the provisions of articles 23 to 26, Regulations 45; a profit or loss was reported on the sale of a company's own stock contrary to the provisions of article 542, Regulations 45; an individual who incorporated his business during the year reported as corporation income the income of the business for the entire year; a taxpayer forgot to deduct the various taxes (other than income, war profits and excess profits taxes) (article 31, Regulations 45) or deducted the same in the wrong year; a taxpayer deducted from income a reserve for bad debts, losses or for injuries and damages whereas the 1918 act does not provide for such deductions; a taxpayer did not take advantage of the provisions of articles 161 and 143, Regulations 45, which permit a deduction for obsolescence and loss of useful value; a taxpayer did not take advantage of credit allowed for foreign taxes paid or if he did take such a credit the foreign taxes were later revised which made necessary a revision of American taxes (article 381, Regulations 45); a good many overassessments were caused by the abatement of jeopardy assessments made as the result of a super-

ficial audit and in other instances the full amount of tax liability was assessed on the original and the amended return causing a duplication of assessments; profit or loss on sale of stock rights was often miscomputed prior to the issuance of bureau rulings (see T. D. 3403, C. B. I-2, p. 64); there was erroneously included in returns income from tax-exempt securities or income which accrued prior to March 1, 1913; a taxpayer failed to take advantage of section 234 (a) (5) of the revenue act of 1921 which permits the partial write-off of bad debts; a taxpayer determined that income from Government contracts was derived in a certain year pursuant to the provisions of article 52, Regulations 45, with a different rule prescribed by article 51 of Regulations 62; or a company computed its taxes at the ordinary corporation rates but found that it was entitled to personal service classification which made necessary a recomputation of the corporation's and usually the shareholders' tax liability.

It is obvious that most of the mistakes above referred to (which are cited merely as examples of the more general class of mistakes) worked both ways and probably as often resulted in additional taxes as in overassessments. For example, matters of depreciation, depletion, gain and loss on sale of assets and inventories often being difficult of proper determination many taxpayers through their lack of understanding of the matters reported too small a tax and were later assessed additional taxes while others reported too great a tax and were later allowed overassessments. *It should be kept in mind that we are here dealing primarily with that class of taxpayers which overpaid their taxes and where a correction of the type of mistakes above referred to usually worked to the taxpayer's advantage.*

An examination of the cases submitted to the joint committee shows that one of the major causes for the overassessments is the application of the special assessment provisions of the 1917 and 1918 acts (sec. 210, revenue act of 1917; sec. 327-328, revenue act of 1918). The amount of overassessments due to this cause as shown by the present report is \$18,920,663.84, or 10.5 per cent of the total overassessments. The amount allowed through the special assessment provisions as shown in the present report is substantial and seems to call for a few comments.

It should first be noted that special assessment is mandatory where, under the provisions of section 327 (a), the commissioner is unable to determine the invested capital as provided in section 326 and under the provisions of section 327 (b) where a foreign corporation is involved and under the provisions of section 327 (c) where a mixed aggregate of tangible and intangible property has been paid in for stock or for stock and bonds and the commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment or to distinguish the classes of property paid in for stock and bonds, respectively. Many of the overassessments covered in the present report fall within subdivisions (a) and (c) and a few within (b). The language and intent of these provisions of the act are quite clear. This type of case involves primarily a matter of judgment as to whether the facts in a particular case are such as to bring the taxpayer within the meaning and intent of the statute.

It is also worthy of note that in view of the provisions of subdivisions (a) and (c) of section 327 much time and effort both on the part of the taxpayer and the Government have been saved in reconstructing capital accounts to meet the requirements of section 326. In a great many of these cases it is quite apparent that capital could have been built up under section 326 to a point greater than that shown on the return which would have produced substantial overassessments even though it may have been known that there was still considerable capital which could not be proven. Overassessments which would have resulted from these reconstructed capital accounts should theoretically at least be offset against the overassessments due to special assessment. It is believed that this point is often overlooked in reviewing the administration of the special assessment provisions. It is also not inconceivable that had it not been for the abnormal condition provisions found in section 327 (d) of the 1918 act retroactive legislation would have been passed following the war period giving relief in some manner to those companies which were inequitably taxed under the complicated provisions of the excess and war profits tax laws.

Another point which should be noted is that in one sense practically all of the overassessments due to special assessment are sustained by the board decisions since the board has adopted practically all, if not all, of the bureau's fundamental principles covering special assessment and even in some instances extended the relief provisions beyond the bureau's interpretation thereof. This appears from the comparison of bureau rulings and board decisions pertaining to special assessment as set forth below.

For the purpose of the present report, however, the overassessments due to special assessment (\$18,920,663.84 or 10.5 per cent of the overassessments) have not been listed as due to board decisions. The argument might be made that although the board has adopted the fundamental principles of the bureau in matters of special assessment, nevertheless this type of case must be judged on its own particular facts so that the matter is one largely in the discretion of the commissioner. This is true but when the very large number of taxpayers which have been granted special assessment by the board after the bureau had disallowed special assessment in these same cases is considered it seems reasonably safe to say that the indications are that the board is more liberal in such matters than the bureau.

The following is a comparison between bureau rulings and board decisions in special assessment cases.

L. O. 1109, C. B. I-2, page 253, holds that the phrase "abnormal conditions affecting the capital or income of the corporation" includes the following cases, among others:

L. O. 1109

(a) Where a corporation is placed in a position of substantial inequality because of the time or manner of organization. (Also A. R. R. 110, C. B. 2, p. 303.)

(b) Where the capital employed although a material income-producing factor is very small or in a large part borrowed.

(c) Where there are excluded from invested capital computed under section 326 intangible assets of recognized value and substantial in amount built up or developed by the taxpayer.

(d) Where the net income for the year is abnormally high, due to realization in one year of (1) income earned during a period of years (also A. R. R. 588, C. B. 5, p. 301) or (2) extraordinary profit derived from the sale of property the principal value of which has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, or (3) gain derived in one year from the sale of property the increase in value of which had accrued over a period of years.

(e) Where proper recognition or allowance can not be made for amortization, obsolescence, or exceptional depletion due to the World War.

OTHER BUREAU RULINGS

L. O. 1000-A, C. B. 2, page 299, recognizes that abnormal conditions affecting capital or income in prewar years may be a cause for special assessment.

S. M. 4877, C. B. V-1, page 340, recognizes that payment of low officers' salaries may be a ground for special assessment in certain cases.

In A. R. R. 332, C. B. 3, page 362, the bureau allowed special assessment where a stockholder paid in to the corporation an intangible asset of substantial value for a nominal consideration.

The bureau has allowed special assessment where a company spent substantial sums in advertising special brands of merchandise all of which expenditures were charged to operating expense (A. R. M. 12, C. B. 2, p. 292; A. R. M. 141, C. B. 5, p. 296).

Sustained by the following Board of Tax Appeals decisions:

National Casket Co., 3 B. T. A. 954; D. N. & E. Walter & Co., 4 B. T. A. 142; Rothschild Colortype Co. v Commissioner, 14 B. T. A. 718.

Standifer Construction Co., 4 B. T. A. 525; E. B. Ficklen Tobacco Co. v Commissioner, 10 B. T. A. 51.

Meade Cycle Co. v. Commissioner, 10 B. T. A. 887; J. G. Curtis Leather Co., 13 B. T. A. 1259.

Pittsburgh Supply Co. v. Commissioner, 14 B. T. A. 620; Wallis Tractor Co. v. Commissioner, 3 B. T. A. 981.

Apparently not ruled upon by the board. This is of extremely limited application.

Guarantee Construction Co., 2 B. T. A. 1145.

Sol Frankel (Inc.), 3. B. T. A. 494, and other B. T. A.'s cited in S. M. 4877,

In J. M. & M. S. Browning Co., 6 B. T. A. 914, the board allowed special assessment under substantially the same circumstances sustaining the bureau's prior allowance of special assessment in the same case but denied the taxpayer's claim for paid-in surplus.

Northwestern Yeast Co., 5 B. T. A. 232; Geo. W. Caswell Co. v. Commissioner, 14 B. T. A. 15.

In the following cases the board seems to have gone beyond the bureau in the recognition of abnormal conditions:

BUREAU RULINGS

A. R. R. 518 refused to recognize a favorable contract as a cause for special assessment.

The bureau has held that exclusion of intangibles under the 20 and 25 per cent limitation provisions of the 1917 and 1918 acts (sections 207 and 326) is not a cause for special assessment and that a cause does not exist through the operation of section 331 of the 1918 act. (See A. R. R. 599, C. B. 5, p. 304.)

Special assessment allowed by board in—

Rex Machinery Co., 3 B. T. A. 182.

J. H. Guild Co. v. Commissioner, 11 B. T. A. 914;

Detroit Opera House Co., 13 B. T. A. 587;

Clarence Whitman & Sons (Inc.), 11 B. T. A. 1192.

It will be noted from the attached Exhibit A that interest paid on amounts refunded or credited in income tax cases amounted to \$28,424,550.62 or 21.7 per cent of the amounts refunded and credited.

Practically all the foregoing general discussion pertains to income and profits taxes. The following is the situation with respect to miscellaneous taxes:

In the 61 miscellaneous cases that were examined 46 were estate tax, 10 gift tax, 1 beverage tax, 1 tax on initiation fees, 2 capital stock tax, and 1 sales tax. The tax originally assessed in these cases was \$65,876,021.36, the additional tax assessed was \$14,731,146.79 and the total amount refunded was \$11,585,926.58. (The figures have been included in the comparisons made in the first part of this report.) The refunds in these cases were over \$3,000,000 less than the additional taxes assessed. A summary of the causes of the refund, the amount and the percentage to the total refunds is as follows:

Cause	Amount	Percentage
Court decisions.....	\$6,251,053.66	54
Board decisions.....	349,815.33	3
Retroactive rates.....	2,381,689.73	20
Other causes.....	2,603,367.86	23

The principal causes of the refunds were court decisions holding certain provisions of the estate and gift taxes unconstitutional or not retroactive, the retroactive rates imposed by sections 322 and 324 of the revenue act of 1926, and "other causes." A summary of the "other causes" is as follows:

Administration expenses, attorneys' fees, executors' commissions...	\$606,950.21
Transfers excluded from gross estate.....	735,457.27
Charitable deductions.....	518,319.58
Valuations.....	353,828.26
Credits for inheritance taxes.....	122,450.72
Miscellaneous items.....	266,359.82

The refund for administration expenses, executors' commissions, and attorneys' fees is largely due to the fact that they were paid and allowed by the probate courts after the filing of the return and the payment of the Federal estate tax. Of the transfers excluded from the gross estate, more than half arose from the settlement of two cases which were in litigation. The total abatements were \$767,-

583.69, of which \$435,197.53 was due to retroactive rates, \$178,000.15 to credits for inheritance tax, and the remainder to miscellaneous adjustments.

It is believed that this report and attached schedules present a fair and impartial analysis of claims cases.

Exhibits are attached concerning cases submitted to the joint committee as follows:

A—General classification of overassessments in income tax cases.

B—Analysis of overassessments in income tax cases by court and board decisions, etc.

C—Subanalysis of "balance of overassessments" in income tax cases.

D—General classification of overassessments in miscellaneous tax cases.

E—Analysis of overassessments in miscellaneous tax cases by court and board decisions, etc.

EXHIBIT A

Distribution of overassessments reported to congressional committee, income tax cases

Board decisions:		
Refund	\$10, 733, 738. 12	
Abatement	5, 531, 396. 64	
Credit	5, 154, 310. 05	
Total		\$21, 419, 444. 81
Court decisions:		
Refund	23, 733, 343. 28	
Abatement	2, 529, 214. 76	
Credit	2, 448, 890. 89	
Total		28, 711, 448. 93
Statutory provisions:		
Refund	16, 448, 966. 39	
Abatement	4, 089, 273. 66	
Credit	4, 488, 156. 41	
Total		25, 026, 396. 46
Duplicate assessment:		
Refund	969, 400. 94	
Abatement	8, 582, 214. 45	
Credit	2, 186, 014. 88	
Total		11, 737, 630. 27
Balance of overassessment:		
Refund	46, 621, 025. 59	
Abatement	13, 937, 603. 78	
Credit	20, 339, 977. 99	
Total		80, 898, 607. 36
Total of overassessments reported to committee		167, 793, 527. 83
Total interest refunded on above overassessments		28, 424, 550. 62
Amount of above overassessments caused by shift of income		24, 854, 767. 88
Amount of tax in respect of other years or taxpayers caused by such shift of income		27, 871, 192. 82

EXHIBIT B

Income tax—Analysis of overassessments

1. COURT DECISIONS

Name of case	Citation	Refund	Amount of abatement	Credit
New York & Albany Lighterage Co. <i>v.</i> Bowers.	273 U. S. 346	\$126,608.86		
International Curtis Marine Turbine Co. <i>v.</i> U. S.	63 Ct. Cls. 597	92,603.83		
Blair <i>v.</i> U. S. ex rel. Birkenstock	271 U. S. 348	12,762.68		
Salt's Textile Mfg. Co. <i>v.</i> Victor & Achells.	26 Fed. (2d) 249	101,060.33		\$126,969.06
Nat'l Life Ins. Co. <i>v.</i> U. S.	277 U. S. 508	8,309,763.96	\$584,303.75	749,499.16
Pitney <i>v.</i> Duffy	2 Fed. (2d) 230	2,895.52		
Duffy <i>v.</i> Mutual Benefit Life Ins. Co.	272 U. S. 613	3,665,273.91		
Reinecke <i>v.</i> Gardner, Tr. O'Gara Coal Co.	277 U. S. 239	282,635.10	181,565.74	17,458.70
Clinchfield Navigation Co., Inc., <i>v.</i> U. S.	P. H. tax, service, 1928, p. 236.	109,732.37		
United Cigar Stores Co. of Amer. <i>v.</i> U. S.	62 Ct. Cls. 134	4,198,108.29		
Keith <i>v.</i> Johnson	271 U. S. 1	1,554,719.19		
Bowers <i>v.</i> Slocum	20 Fed. (2d) 350	1,618,939.93		
Penna. Mutual Life Ins. Co. <i>v.</i> Lederer.	252 U. S. 523	54,727.60		
Girard Tr. Co. <i>v.</i> U. S.	270 U. S. 163	573,359.40		
U. S. <i>v.</i> Phellis	257 U. S. 156	4,085.69		194,003.08
Miles <i>v.</i> Safe Dep. & Tr. Co.	259 U. S. 247	75,608.98		
Lynch <i>v.</i> Alworth Stephens Co.	267 U. S. 364	545,972.93	6,485.33	329,217.92
McHale <i>v.</i> Hull	16 Fed. (2d) 781	153,639.77		
Bourn <i>v.</i> McLaughlin	19 Fed. (2d) 148	227,059.62		
Semple & Co. <i>v.</i> Lewellyn	1 Fed. (2d) 745	36,782.38	31,193.20	10,728.40
Eisner <i>v.</i> Macomber	252 U. S. 189	68,308.78	3,205.25	33,183.84
Schuster & Co. <i>v.</i> Williams	283 Fed. 115	26,529.82		541.95
Hecht <i>v.</i> Malley	265 U. S. 144	119,541.64		225,884.79
Nat'l City Bk. of Seattle <i>v.</i> U. S.	64 Ct. Cls. 236	13,119.70		
Brewster <i>v.</i> Walsh	255 U. S. 536	178,377.55	752,792.81	
Houston, Fible & Co., Bankrupt Docket.	No. 4192 Bkpt., Dist. Ct. Mo.	183,207.10	101,772.95	
Sargent Land Co. <i>v.</i> Von Baumbach	242 U. S. 503			55,454.47
Routzahn <i>v.</i> Mason	275 U. S. 175	34,597.17		
Alien Property Custodian	4 Fed. (2d) 1006	556,345.23	2,313.77	151,049.52
Standard Oil Co. of N. Y. <i>v.</i> U. S.	61 Ct. Cls. 906 and 951	80,000.00	717,000.00	155,000.00
Anderson <i>v.</i> U. S.	269 U. S. 422		9,455.18	
Reid <i>v.</i> Rafferty	15 Fed. (2d) 264	108,469.65	139,223.78	
Hollingsworth & Whitney Co. <i>v.</i> Collector.	Stipulation Dist. Ct. Mass.	516,446.33		
Wilkinson <i>v.</i> Hamilton Mfg. Co.	19 Fed. (2d) 365			400,000.00
U. S. White Dental Co. <i>v.</i> U. S.	274 U. S. 398	101,999.97		
Total		23,733,343.23	2,529,214.76	2,448,890.89

2. BOARD OF TAX APPEALS DECISIONS

Union Metal Manufacturing Co.	1 B. T. A. 395	\$498,402.00	\$43,618.98	\$269,523.05
Regal Shoe Co.	1 B. T. A. 896	2,083,350.85	3,538,437.72	203,547.73
Manville Jenckes Co.	4 B. T. A. 765	517,444.89	48,851.19	5,134.62
Theodore Stanfield	8 B. T. A. 787	155,932.91		63,574.24
Elizabeth S. Sprague	8 B. T. A. 173	77,561.95		
G. M. Standifer Constructing Corporation.	4 B. T. A. 525	438,751.43		
National Grocer Co.	1 B. T. A. 688	220,900.00	15,693.01	276,580.13
Isse Koch & Co. (and related cases)	1 B. T. A. 624	1,034,468.00	259,876.69	41,270.64
Coghlin Electric Co.	3 B. T. A. 1071	49,593.35	868.59	80,088.74
Grosvenor Atterbury	1 B. T. A. 169	441,694.39	5,554.48	370,686.28
Bartles-Scott Oil Co.	2 B. T. A. 16	84,170.65		
New Process Cork Co.	3 B. T. A. 1339	39,423.91		
Goodell-Pratt Co.	3 B. T. A. 30	205,815.69	10,022.39	774.77
John W. Butler (Inc.)	1 B. T. A. 1105	19,492.79		
American LaDentelle (Inc.)	1 B. T. A. 575	163,944.40		65,211.57
Retailers Fire Insurance Co.	3 B. T. A. 1186	66,804.07		
Detroit Vapor Stove Co.	4 B. T. A. 1043	3,688.59	76,445.54	56,502.87
St. Louis Screw Co.	2 B. T. A. 649	95,095.07	69,922.84	6,545.28
Lexington Brewing Co.	8 B. T. A. 755	38,379.06		
Schmoller & Mueller Piano Co.	1 B. T. A. 498	33,564.02		4,468.05
Poinsett Mills	1 B. T. A. 6	59,700.00		
James Dobson	1 B. T. A. 1082	80,750.29		

Income tax—Analysis of overassessments—Continued

2. BOARD OF TAX APPEALS DECISIONS—Continued

Name of case	Citation	Refund	Amount of abatement	Credit
Illinois Merchants Transfer Co., executor of estate of Wm. R. Maniere	4 B. T. A. 103	\$67,367.07		
R. Downes	5 B. T. A. 1029	65,876.46		\$107.70
Stevens Manufacturing Co.	1 B. T. A. 610	264,999.58	\$50,541.45	459,033.70
Citizens Transfer Co. of Utica	2 B. T. A. 1239	4,859.04		
Jamestown Worsted Mills	1 B. T. A. 659	87,549.42		
Standard Marine Insurance Co. (Ltd.)	4 B. T. A. 853	98,464.03		
Mather Paper Co.	3 B. T. A. 1	11,723.14	239,756.99	
Sheridan Coal Co.	4 B. T. A. 563	110,414.81		
Orents Department Stores (Inc.)	3 B. T. A. 52		862.00	118,855.71
Clendening Co.	1 B. T. A. 622	13,112.62	47,701.47	19,668.92
Illinois Terminal Co.	5 B. T. A. 15	138,478.81		
Great Northern Ry. Co.	8 B. T. A. 225	16,398.81		
American-Hawaiian Steamship Co.	7 B. T. A. 13	1,500.00	15,400.00	3,000.00
Chatham & Phenix National Bank	1 B. T. A. 460	30,880.87		58,524.61
McCoy-Brandt Machinery Co.	8 B. T. A. 909	11,468.37		
Wm. J. Ostheimer	1 B. T. A. 18	128,285.01		
Board decisions in instant case		3,273,431.78	1,107,843.30	3,001,211.44
Total		10,733,738.12	5,531,396.64	5,154,310.05

3. STATUTORY PROVISIONS

Section of law	Refund	Amount of abatement	Credit
Sec. 1116 of the revenue act of 1926	\$447,260.02		
Net losses, various acts	\$1,349,519.82	\$1,788,063.59	\$509,155.88
Sec. 703 of the revenue act of 1928	665,737.34		113,625.29
Sec. 284 (c) of the revenue act of 1926	414,989.70	1,949.13	25,221.30
Sec. 1208 of the revenue act of 1926	111,116.80	220,075.88	201,994.50
Secs. 210 and 327 and 328 of the revenue acts of 1917 and 1918	13,582,132.76	1,844,222.07	3,494,309.01
Sec. 304 (c) of the revenue act of 1921	73,762.49		
Sec. 330 of the revenue act of 1918	285,892.67	234,962.99	143,850.43
Sec. 607 of the revenue act of 1923	118,556.79		
Total	16,448,966.39	4,089,273.66	4,488,156.41

4. DUPLICATE ASSESSMENTS

Amount	\$969,400.94	\$8,582,214.45	\$2,186,014.88
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5. BALANCE OF OVERASSESSMENTS

Per analysis attached exhibit	\$46,621,025.59	\$13,937,603.78	\$20,339,977.99
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EXHIBIT C

Analysis of classification—Balance of overassessment—Income taxes

Item	Refund	Abatement	Credit	Total	Per cent
Depreciation	\$3,975,443.03	\$1,188,479.85	\$1,734,419.66	\$6,898,342.54	8.527
Depletion	1,667,547.12	498,522.09	727,523.07	2,893,592.28	3.577
Obsolescence	917,950.00	274,426.04	400,486.32	1,592,862.36	1.969
Inventories	3,658,669.02	1,093,778.58	1,596,216.43	6,348,664.03	7.848
Changes in affiliation	2,526,321.14	755,257.15	1,102,191.89	4,383,770.18	5.419
Losses	830,004.45	248,134.25	362,117.14	1,440,255.84	1.780
Invested capital	8,832,342.01	2,640,475.66	3,853,403.91	15,326,221.58	18.945
Amortization	7,502,735.83	2,242,982.82	3,273,318.85	13,019,037.50	16.093
Shifts of income	8,393,870.72	2,509,392.34	3,662,106.18	14,565,369.24	18.004
Miscellaneous	8,316,142.27	2,486,155.00	3,628,194.54	14,430,491.81	17.838
	46,621,025.59	13,937,603.78	20,339,977.99	80,898,607.36	100.000

EXHIBIT D

Distribution of overassessments reported to congressional committee—Miscellaneous tax cases

Board decisions:		
Refunds.....		\$349, 815. 33
Court decisions:		
Refunds.....	\$6, 251, 053. 66	
Abatement.....	55, 054. 59	
Total.....		6, 306, 108. 25
Statutory provisions:		
Refunds.....	2, 381, 689. 73	
Abatement.....	435, 197. 53	
Total.....		2, 816, 887. 26
Balance of overassessment:		
Refund.....	2, 603, 367. 86	
Abatement.....	277, 331. 57	
Total.....		2, 880, 699. 43
Total of overassessments.....		12, 353, 608. 31
Total interest on above overassessments refunded.....		1, 471, 492. 12
Amount of tax collected in connection with the audit of the above cases.....		40, 000. 00

EXHIBIT E

Distribution of overassessments reported to joint committee—Miscellaneous taxes

COURT DECISIONS

Number of cases	Name of case	Citation	Refund	Abatement
ESTATE TAX				
3	Blount v. United States.....	58 Ct. Cl. 328.....	\$453, 606. 06	-----
1	Keith v. Johnson.....	271 U. S. 1.....	143, 423. 82	-----
8	Nichols v. Coolidge.....	47 S. C. 710.....	3, 942, 034. 85	\$529. 00
1	Julliard v. United States.....	Ct. Cl.....	77, 797. 16	-----
1	Llewellyn v. Frick.....	268 U. S. 238.....	594. 41	5, 356. 66
	Total.....	-----	4, 617, 456. 30	5, 885. 66
GIFT TAX				
6	Untermeyer v. Anderson.....	48 S. Ct. 353.....	1, 082, 985. 26	-----
2	Blodgett v. Holden.....	48 S. Ct. 105.....	485, 495. 57	49, 168. 93
	Total.....	-----	1, 568, 480. 83	-----
MISCELLANEOUS TAX				
1	Lukens v. United States.....	62 Ct. Cl. 598.....	65, 116. 53	-----
	Total court decisions.....	-----	6, 251, 053. 66	55, 054. 59

BOARD DECISIONS

Name of case	Citation	Refund	Abatement
Estate tax:			
4. William Harris.....	5 B. T. A. 41.....	\$349, 815. 33	-----
Statutory retroactive rates, secs. 322 and 324, revenue act 1926:			
15 Estate tax.....		2, 070, 454. 73	-----
2 Gift tax.....		311, 235. 00	\$435, 197. 53
Total.....		2, 381, 689. 73	-----
Balance of overassessment.....		2, 603, 367. 86	277, 331. 53
Total miscellaneous overassessments.....		11, 585, 926. 58	767, 583. 65

PART III

PART III

STUDY OF INDIVIDUAL CASES

All refunds and credits in excess of \$75,000 have been reported to the joint committee by the Commissioner of Internal Revenue for the period June 1, 1928, to December 31, 1928. The report on these cases includes not only the amount of refund and credit but also the amount of the abatement, if any, and the amount of interest allowed. In addition to this report there is included the decision of the commissioner in these cases which consists of a memorandum prepared by the general counsel of the Bureau of Internal Revenue approved by the commissioner.

The decision of the commissioner above noted is always carefully reviewed by this division, and in many instances this study has been deemed sufficient for the purposes of the joint committee. Where there is any reasonable doubt about the propriety of the allowances the entire file of the case is called for and examined in detail.

Taken as a whole, it is believed that the refunds and credits made show very careful and intelligent handling by the commissioner and his bureau in the face of many difficulties.

It appears instructive to sum up a few of the most interesting points in some of the cases which have been submitted. It is proposed to make this discussion as brief and understandable as possible and most of the technical detail is omitted. Where it appears necessary there will be included in the appendix the decision of the commissioner or other technical matter.

The position of the bureau as to the points raised in our summing-up statements is in each case, where necessary, inserted immediately following such statements in order that both sides of the question may be fairly considered.

CASE NO. 8—JUNE

This is the case of the Chatham & Phenix National Bank of New York. The refund allowed for the years 1918, 1919, and 1920 amounts to \$117,959.03 plus interest of \$21,691.22. The principal cause for the refund in this case is the application of the special assessment provision of the revenue act of 1918. This provision, as is shown by the decision of the Supreme Court in the Williamsport Wire Rope case, is applied entirely at the discretion of the commissioner.

The fact to which we particularly desire to draw attention in this case is that the United States Board of Tax Appeals rendered a decision in the case of this taxpayer for the years 1918 and 1919 on January 31, 1925. After the taxpayer has had his day in court and a final decision of the Board of Tax Appeals handed down, the commissioner has seen fit to reopen the case for the same taxable years and give the taxpayer relief through the application of the special-assessment provision. While the legality of this procedure is not

questioned, it does seem that the propriety of such a policy may be criticized. It is usual for the taxpayers to bring forward all of their defense before the Board of Tax Appeals, and if there is any reasonable ground for special assessment to make contention for it at that time. It appears obvious that if the Government pursues a policy of allowing cases to be reopened after the Board of Tax Appeals has spoken, we will never get current with our income-tax controversies.

The decision of the commissioner in this case will be found in Appendix 2.

POSITION OF THE BUREAU

The bureau position, as stated in a letter, included as Appendix 2 (A), is:

Although no criticism is made of the refund allowed in this case, it seems advisable to point out, in response to the above comments, that the decision of the Board of Tax Appeals in this case was under the 1924 act. Under that act the board had no jurisdiction over refunds and hence the prosecution of a claim before the bureau after the promulgation of the board decision was proper.

Shortly after the enactment of the revenue act of 1926 the bureau, as a matter of administrative policy, adopted the position that cases in which a board decision has been rendered would not be reopened except with the approval of the commissioner in cases in which the refund is clearly allowable. In no case has the issue involved in the board proceedings been reconsidered by the bureau. The issue upon which the refund was allowed in this case was not involved in the proceedings before the board.

CASE NO. 9—JUNE

This is the case of the Cole Motor Car Co., of Indianapolis, Ind. The total refund allowed amounts to \$229,439.80 plus interest of \$88,081.04. The years involved are 1918 to 1921, inclusive.

The principal cause of the refund in this case is the application of the special-assessment provisions of the revenue acts of 1918 and 1921. No criticism was offered to the decision in this case in accordance with the report of the examiner of the committee which will be found in Appendix 3. The case is mentioned here merely to show that certain cases seem to come squarely within the special-assessment provisions.

POSITION OF THE BUREAU

Inasmuch as it is stated that this case falls clearly within the provisions of the law, comment by the bureau is unnecessary.

CASE NO. 12—JUNE

This is the case of Eisemann Bros., Boston, Mass. The refund allowed amounts to \$193,072.08 plus interest of \$117,538.58. The year involved is the taxable year 1917.

The principal cause of the refund in this case is the application of the special-assessment provision, section 210 of the revenue act of 1917, on account of an abnormality in the amount of borrowed capital. The decision of the commissioner in this case will be found in Appendix 4. The protest of this division will be found in Appendix 5. The reply of the department to the protest will be found in Appendix 6.

The whole point in this case is whether special assessment for 1917 shall be allowed under the same rules as for 1918. The Board of Tax Appeals in the case of the West End Consolidated Mining Co. (3 B. T. A. 128), said in reference to section 210 of the revenue act of 1917:

This section provides only *one ground* for special relief, namely, that the Secretary of the Treasury is unable to satisfactorily determine the invested capital. * * * There is nothing in the history of this section to which our attention has been called or which we have been able to find which would extend the scope of the section *beyond its words*.

In the case of the Duquesne Steel Foundry Co., Board of Tax Appeals Docket No. 5217, the member sustained the objection of counsel for the commissioner excluding evidence as to borrowed capital as constituting an abnormality which would allow the taxpayer special assessment for 1917.

The language of the 1918 statute in regard to special assessment is entirely different from the 1917 statute. There is absolutely no reference in the 1918 act as to this section being retroactive, yet the commissioner insists on making this 1918 statute retroactive in refund cases, in spite of the opinion of the Board of Tax Appeals. To do otherwise would evidently curtail his discretionary power for the year 1917.

When the inconsistency of being more liberal in the case of refunds than in the case of additional taxes was drawn to the attention of the bureau by this office, it is understood that the procedure has been changed so as to make the same liberal policy apply to 1917 additional taxes.

This division does not agree with the commissioner's action in this case. Reliable information is to the effect that a very large percentage of the relief went not to the taxpayer but to the tax experts. It should be noted also that this case was denied three times before being finally allowed.

POSITION OF THE BUREAU

The position of the bureau, as set forth in the letter included as Appendix 6, is:

Abnormalities of capital or income are grounds for the allowance of assessment under the provisions of section 210 of the revenue act of 1917.

The consistent interpretation of the bureau, based primarily upon the legislative history of the revenue acts, should not be reversed at this time.

Every effort is made by the bureau to maintain a uniform position as to the interpretation and application of the provisions of the revenue acts, whether a deficiency or overassessment is involved.

CASE NO. 21—JUNE

This is the case of P. Lorillard & Co. of New York. The refund allowed amounts to \$1,231,006.76 plus interest of \$199,591.72. The year involved is 1918.

The principal cause of the refund in this case is the application of the special-assessment provisions, sections 327 and 328 of the revenue act of 1918. The decision of the commissioner will be found in Appendix 7.

The features of this case are exactly similar to the refund allowed to the R. J. Reynolds Tobacco Co., already completely described in our first refund report. The Lorillard case, however, was allowed just subsequent to the decision of the Supreme Court of the United States in the Williamsport Wire Rope Co. case. The Reynolds case was allowed prior to this decision. The decision, itself, holds that the application of the special-assessment provisions is discretionary with the commissioner, and that, therefore, the taxpayer can not collect refunds from the courts on this ground.

The position of this division is briefly summarized in the following letter:

JULY 12, 1928.

MR. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury,
Washington, D. C.

DEAR MR. ALVORD: In connection with the overassessments totaling \$1,231,-006.76 proposed in the case of P. Lorillard & Co. of New York, and submitted to this committee on June 21, 1928, the following comments are made:

This division has substantially the same opinion in regard to this allowance as in the case of the R. J. Reynolds Tobacco Co. (our letter dated August 9, 1927). However, as the bureau, after review, did not sustain our opinion in the Reynolds case, to request another review on the same points in this case would appear to occasion unnecessary work, and, therefore, such a request is not made.

On June 4, 1928, the Supreme Court of the United States held in the Williamsport Wire Rope Co. case that the courts were without jurisdiction to review the determination of the commissioner in special assessment cases. In view of the fact that during our investigation of the R. J. Reynolds case we were informed that the case was allowed because it was feared that the taxpayer would get a larger refund by going to the courts and using the American Tobacco Co. as a comparative, it would seem proper to request your consideration of the question as to changing the policy of the bureau in such cases as this, where "no exceptional hardship" is proven, and where the taxpayer is not entitled to relief except through Executive action.

It is not desired to bring about any loss of interest to the Government in this case, but as the date of payment is not until July 21, it is believed sufficient consideration can be given to our second comment in the nine days available.

Very truly yours,

L. H. PARKER.

POSITION OF THE BUREAU

The position of the bureau is that the allowance of special assessment and the amount of relief granted in the Reynolds Tobacco Co. and P. Lorillard Co. cases are proper for the reasons set forth in Appendix 7 (A).

CASE NO. 23—JUNE

This is the case of the Michigan Tanning & Extract Co., Petoskey, Mich. The refund allowed for the year 1917 amounts to \$147,331.72 plus interest of \$72,999.56.

The principal cause for the refund in this case is the application of the special assessment provision, section 210 of the revenue act of 1917. The 1918 act has been given retroactive effect to 1917 and special assessment allowed on the basis of an abnormality due to invested capital.

This division does not concur in this decision as in the case of Eisenmann Bro. previously described.

POSITION OF THE BUREAU

The position of the bureau upon the question presented is set forth in the discussion in the Eisemann Bros. case previously discussed. (See case No. 12—June, and Appendix 6.)

CASE NO. 31—JUNE

This is the case of the Tribune Co., Chicago, Ill. The refund allowed amounts to \$133,447.11 plus interest of \$49,717.74. The years involved are 1920 and 1921.

The principal causes for the refund in this case are special assessment (secs. 327 and 328) and the allowance of an operating loss of a subsidiary organized under the French law. The decision of the commissioner in this case will be found in Appendix 8 and the comments of this division in Appendix 9.

As far as the allowance for special assessment is concerned, it appears that this relief is reasonable and proper. The interesting point in this case is the deduction from the income of the Tribune Co. of Chicago of an operating loss sustained by the Tribune Co. of France, a foreign corporation.

This loss seems to have been finally allowed on account of a contract entered into in March, 1922, between the two companies purporting to confirm a former verbal arrangement for the year 1921. This contract provides for the operating losses of the French company being paid by the Chicago company. The issue seems to be doubtful from a legal standpoint, but has finally been allowed in favor of the taxpayer.

If the decision in this case is correct, it will be seen that the method employed in this case can be advantageously used by any corporation having foreign subsidiaries, so that it may get the benefit of the losses of foreign subsidiaries and still escape the United States taxes in years when these subsidiaries have profits. This point may be properly considered in future legislation.

POSITION OF THE BUREAU

The position of the bureau, as set forth in the letter included as Appendix 9 (A), is:

The loss sustained through a contract arrangement with a foreign subsidiary company constitutes an allowable deduction to the taxpayer company.

With respect to the recommendation as to future revenue acts, it is noted that Congress, upon the recommendation of the Treasury, enacted section 240 (d) of the 1921 act and similar sections in later acts to prevent shiftings of income or losses between related businesses. If a more effective control of this situation can be suggested, the Treasury will recommend its adoption.

CASE NO. 1—JULY

This is the case of the Aluminum Co. of America and subsidiaries. The overassessment allowed amounts to \$1,287,426.64, of which approximately one-half is refunded and one-half is credited against 1923 taxes. Interest has not yet been allowed but it appears it will be computed and remitted later. The year involved is 1917.

The principal cause for the overassessment in this case lies in the adjustment of opening inventories. Examination reveals that these adjustments have been made properly on the basis of the facts reported. The decision of the commissioner will be found in Appendix 10.

This company and its numerous subsidiaries filed a consolidated return for 1917, and while the computation of the consolidated invested capital of the group is not the cause of the refund, a few words may be said as to this determination.

The consolidated invested capital appears to have been computed in accordance with the regulations. Later, it will be shown in the case of the United States Steel Corporation that the bureau did not follow the regulations but adopted an adjusted basis in view of different rules laid down by the Court of Claims, the Board of Tax Appeals, and the regulations. Both the Aluminum case and the Steel case are for the year 1917, so it may be concluded that the bureau will not always find it necessary to adopt the settlement method in determining consolidated invested capital as used in the United States Steel case.

POSITION OF THE BUREAU

As no criticism of the refund is made, no comment by the bureau is necessary. It might be pointed out, however, that the determination of the tax liability resulting in the above overassessment was made before the decision in the Grand Rapids Dry Goods case (12 B. T. A. 696) was promulgated, and that the settlement of the case, acquiesced in by the taxpayer, is less favorable to it than would have resulted if the theory adopted by the board in the Grand Rapids decision (which had been urged by the taxpayer) had been taken into consideration. On the other hand, the Steel case for 1917 was settled after the Grand Rapids decision, and the theory there adopted by the board was less favorable to the taxpayer than the theory of the United Cigar Stores case or of the regulations.

CASE NO. 2—AUGUST

This is the case of the Cadillac Chemical Co. and its subsidiary, the Mitchell-Diggins Iron Co., both of Michigan. The total refund allowed amounts to \$221,301.88 plus interest of \$124,250.35. The years involved are 1917 and 1918.

The principal cause for the refund in this case is the application of the special-assessment provisions. Inasmuch as we have already discussed this same matter several times in this report, it is deemed sufficient to submit the decision of the commissioner in Appendix 11 and the comments of Mr. Chesteen, our corporation auditor, in Appendix 12. The final action was recommended by the special advisory committee of the bureau, established in the summer of 1927.

POSITION OF THE BUREAU

The position of the bureau, as set forth in a letter included as Appendix 12 (A), is:

That abnormalities in both capital and income existed in this case so that the allowance of special assessment was proper.

CASE NO. 5—AUGUST

This is the case of the Cleveland-Cliffs Iron Co., Cleveland, Ohio. The total overassessment allowed amounts to \$115,361.45 plus interest of \$34,905.49. The overassessment is partly refunded in cash and partly credited and abated. The year involved is 1918.

The principal causes for the allowance in this case are amortization and recomputation of invested capital. The decision of the commissioner will be found in Appendix 13 and the comments of Mr. Chesteen, corporation auditor for this committee, in Appendix 14. The case is interesting but appears to have been properly computed and is included for illustrative purposes only.

POSITION OF THE BUREAU

As it is admitted that the refund is proper, no comment by the bureau is necessary.

CASE NO. 17—AUGUST

This is the case of John D. Rockefeller, sr., of New York. The refund allowed amounts to \$120,655.28 plus interest of \$36,571.86. The year involved is 1922.

The principal cause of the refund in this case is found in the recomputation of the profit derived from the sale of stock. March 1, 1913, value is involved. No criticism is made of the case but it is illustrative of the difficulty of securing accurate valuations as of March 1, 1913.

The decision of the commissioner in this case will be found in Appendix 15.

It is interesting to note that Mr. Rockefeller's net tax for the year 1922 after securing this refund amounts to \$12,036.03. This small tax would indicate that Mr. Rockefeller's income-producing property has been largely transferred to his heirs or to his numerous charitable foundations. The point, which seems well to consider, is that the Federal estate tax will not produce much revenue in this case. In fact, the result of not taxing gifts is to leave the door wide open for the avoidance of the estate tax, in the case of all our citizens who have accumulated great wealth.

POSITION OF THE BUREAU

As the refund is approved, no comment by the bureau is necessary.

CASE NO. 19—AUGUST

This is the case of the Standard Oil Co. of Kentucky. The refund allowed amounts to \$1,842,055.42 plus interest of \$772,497.12. The years involved are 1919, 1920, and 1921.

The principal cause for the refund in this case is the application of the special-assessment provisions. After the comparatives were examined the decision of the commissioner appeared reasonable. This decision will be found in Appendix 16. The report of Mr. Chesteen of this office, will be found in Appendix 17.

There are only two comments which we desire to make in this case:

First, this case shows that the relief provision, special assessment, under the regular procedure of the bureau is effective in reducing the taxes of our largest and richest taxpayers as well as those taxpayers who were really unable to pay the heavy taxes imposed without financial distress.

Second, it appears that it took this company an extraordinarily long time to discover that it was entitled to special relief for 1919, 1920, and 1921. The application for special assessment was made in March, 1927, approximately 7 years after the payment of the 1919 tax. It seems almost obvious that if the "exceptional hardship" specified by law had really been present in this case, the taxpayer would not have taken 7 years to discover such hardship.

POSITION OF THE BUREAU

As no criticism of the refund is made, no comment by the bureau is necessary. However, reference to certain statements made in Mr. Chesteen's memorandum appears in a letter included as Appendix 17 (A).

CASE NO. 2—SEPTEMBER

This is the case of the American Woolen Co., of Boston, Mass. The overassessment allowed amounts to \$1,214,580.62, which is entirely credited against 1918 additional taxes. There is no interest allowed in this case. The year involved is 1919.

The principal cause for the overassessment is inventory adjustment. Specifically the opening inventory for 1919 has been increased \$6,200,746.03. While this reduces the net income for 1919, it increases the income for 1918. The additional tax for 1918 under the higher rates in force in that year is in excess of \$4,000,000.

It seems but fair to state that in many cases a refund in one year may create on account of the same determined fact an additional tax in another year. This is a case of this kind. The adjustment made which appears on its face so favorable to the taxpayer, as it reduces his tax for 1919 over \$1,000,000, is nevertheless decidedly unfavorable to him, as the same adjustment increases his tax by \$4,000,000 in 1918. It seems unnecessary to submit any exhibits in this case.

POSITION OF THE BUREAU

As the refund is approved, no comment by the bureau is necessary.

CASE NO. 23—SEPTEMBER

This is the case of the Prudential Insurance Co. of America, Newark, N. J. The refund allowed amounts to \$1,503,219.02 plus interest of \$130,402.60. The years involved are 1925 and 1926.

The principal cause for the refund in this case is the recomputation of the net income in accordance with the decision of the Supreme Court of the United States in the National Life Insurance Co. case. The decision of the commissioner in this case will be found in Appendix 18.

There is no criticism to be made of the allowance in this case which is entirely due to the decision of the Supreme Court. This case is simply selected at random from among a considerable number in order to illustrate this type of refund.

When the 1921 revenue act was written, a special deduction from income was provided for life insurance companies consisting of an amount equal to the excess of 4 per cent of the mean reserves over the tax-exempt interest. The Supreme Court decision results in allowing the full 4 per cent of the mean reserves as a deduction instead of the portion of that amount which is in excess of the tax-exempt interest. Of course, we are not making any criticism of the action of the Supreme Court, but we do wish to point out that the law of 1921 in regard to insurance companies really represented an informal agreement between the Congress and the companies as to the basis on which they should be taxed. That basis was decidedly advantageous to the life-insurance companies and the decision of the Supreme Court of the United States makes the basis still more favorable to the taxpayer. In fact, it will probably result in refunds for past years of \$35,000,000 and for future years it will cost the Government about eight or nine million per annum.

This matter has been fully described in our report on "Federal Taxation of Life Insurance Companies" and it would only be a duplication to discuss the question further here. The percentage of tax reduction through this refund in the case of the Prudential Insurance Co. of America is over 45 per cent.

POSITION OF THE BUREAU

As the refund is approved, no comment by the bureau is necessary.

CASE NO. 8—OCTOBER

This is the case of the Marine Securities Co., of Evanston, Ill. The refund allowed amounts to \$757,977.13 plus interest of \$296,-318.66. The years involved are 1919 and 1920.

The principal causes for this refund are found in the application of the amortization and special assessment provisions. This case is summed up in the report of our corporation auditor, Mr. Chesteen, which report is given in full below:

WASHINGTON, November 8, 1928.

MR. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

In re Marine Securities Co., Chicago, Ill.

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the above-named taxpayer's case for the years 1919 and 1920, involving refunds of \$420,230.88 for 1919 and \$337,746.25 for 1920.

The alleged refunds are due to two principal reasons: First, amortization; second, allowance of special assessment. The amortization allowance has been computed on the basis of the sale price of the property made to the Bethlehem Ship Building Co. in the year 1921. Bonds in the amount of \$600,000 par value were received for the property. These bonds have been determined to have a fair market value of \$80 per bond, or \$480,000 for the total amount.

The claim for special assessment is based on the grounds that the commissioner is unable satisfactorily to determine invested capital. The abnormality alleged is based on the fact that the Marine Securities Co. issued, in 1916, \$1,100,000 par value of common stock for a contract to purchase the stock of the Baltimore Dry Dock & Ship Building Co. The record is conflicting and the auditors have taken first one position and then another. The final decision was made by F. D. Strader, formerly legal adviser to the consolidated returns division. After reviewing all the evidence, this individual came to the conclusion that the contracts were of very great value and recommended the allowance of special assessment. On the basis of his recommendation, relief has been granted.

The taxpayer had considerable income in 1919 and 1920 from Government contracts. Considerable difficulty, therefore, was incurred apparently in getting suitable comparatives. There are attached hereto copies of the data sheets used for the years 1919 and 1920. You will note that only one comparative has been used for 1920. It is the contention of the bureau that it was not possible to secure other suitable comparatives for that year. Taking the case as a whole, it would appear that no unfavorable criticism should be offered to the proposed refund unless it was the use of one comparative for 1920. That is a question which the committee has had up with the bureau before, and it is not deemed necessary to repeat previous objections to the use of one comparative.

Respectfully,

G. D. CHESTEEN, *Corporation Auditor.*

POSITION OF THE BUREAU

As the bureau audit is approved, no comment appears necessary as to the propriety of the refund. The bureau letter, included as Appendix 18 (A), points out, however, that the allowance of special assessment is based upon the recommendation of the office of the general counsel and not upon the recommendation of one of its members and that the use of a single comparative company in the preparation of the 1920 data sheet is proper.

CASE NO. 4—NOVEMBER

This is the case of the International Mercantile Marine Co. of New York. The amount of the overassessment in this case amounts to \$1,229,315.91, for the years 1919 and 1920, which amount is credited against additional taxes for 1918. No interest is allowed.

The principal cause for the overassessment is found in the method of crediting taxes paid to foreign countries. The decision of the commissioner in this case will be found in Appendix 19. A letter of Mr. Chesteen, corporation auditor for this committee, together with a supplementary opinion by the general counsel's office will be found in Appendix 20.

This is a very interesting case, but it is too technical to be described fully in this summary. A study of Mr. Ludwig's opinion in Appendix 20 is well worth the attention of those interested in the matter of foreign tax credits. What we wish to bring out here is the absurdity of the result.

During the year 1919, the International Mercantile Marine Co. has income from sources within the United States. The correct tax liability on this income has been computed by the bureau at \$1,433,814.08. This company received during the year 1919 some millions of dollars in dividends from foreign corporations (British) of which it owned nearly 100 per cent of the stock. These dividends were not taxable in the United States under section 234 (a) (6) being "amounts received as dividends from a corporation which is taxable under this title upon its net income" and which amounts are deductible from net income.

Now the tax deducted at the source in Great Britain was \$3,934,364.98. This entire amount is allowed by the bureau as a credit against the United States income tax under their interpretation of section 238 (a). The result of this is to wipe out entirely the tax of \$1,433,814.08 which would have been due on income from sources within the United States.

The above can be made plainer by a hypothetical case. Suppose Company (U. S.) has income from within the United States of

\$3,000,000 upon which our tax would be \$1,000,000. Now suppose this company owns all the stock of a British company, Company (U. K.). This British company has income from sources within the United States of \$2,000 upon which it pays taxes to the United States of \$240. This British company has income from sources without the United States of \$12,000,000 on which it pays a tax of \$3,000,000. Company (U. K.) distributes \$9,000,000 in dividends to Company (U. S.). According to the bureau's interpretation, the United States receives *no tax* from these two companies except \$240, in spite of the fact that it would have received \$1,000,000 additional if Company (U. S.) had not owned stock in Company (U. K.). Of course, Great Britain collects its \$3,000,000 in tax and does not suffer.

This division is not in agreement with the interpretation of the bureau. While our present law has been changed since the 1918 act, it is believed that a report on foreign tax credits would be instructive.

POSITION OF THE BUREAU

The position of the bureau, as set forth in a letter included as Appendix 20 (A), is:

That the bureau interpretation of section 238 (a) of the revenue act of 1918, more specifically set out in Appendix 20 (A), is correct.

CASE NO. 6—NOVEMBER

This is the case of the Middle States Oil Corporation, New York, N. Y. The overassessment allowed amounts to \$4,583,226.77 plus interest of \$33,952.79; \$4,414,805.67 of the above overassessment represents the abatement of jeopardy assessments. The years involved are 1918, 1919, and 1920.

The principal cause of the overassessment in this case appears to be affiliation and the correction of overstated income resulting from defective accounting records. It appears that the original books and records in this case are missing to a considerable extent, some of them at least having been sent out of the country. The decision of the commissioner will be found in Appendix 21, and the report of Mr. Chesteen in Appendix 22.

This case is illustrative of some of the difficult propositions which have to be handled by the bureau. The company itself is in the hands of receivers, Joseph P. Tumulty and Joseph Glass.

POSITION OF THE BUREAU

As no criticism of the refund is made, no comment by the bureau is necessary.

CASE NO. 6—DECEMBER

This is the case of the Estate of William P. Clyde, Brooklyn, N. Y. The refund allowed amounts to \$1,297,307.42 plus interest of \$107,623.20. The date of death was November 18, 1928.

The principal cause for the refund in this case lies in the final determination that certain gifts were not made in contemplation of death, and that they were valid gifts properly ratified by the donor.

A very careful examination was made of this case. The decision of the commissioner is not included on account of its length, 28 pages.

While the questions involved are entirely fact questions the evidence is exceedingly scanty and even conflicting. Three members of the estate-tax division were interviewed and they all expressed the personal opinion that the refund should not be allowed. Two members of the general counsel's office were interviewed and they were both of the opinion the refund should be allowed.

This division was of the opinion, after the examination above referred to, that if reasonable doubt was resolved in favor of the taxpayer the refund could be considered proper. Whether the case might properly have been fought out in the courts appeared to be an open question.

POSITION OF THE BUREAU

The position of the bureau is that the settlement in this case was based upon a well-considered opinion of the general counsel and is sound.

CASE NO. 16—DECEMBER

This is the case of the Ohio Oil Co. and subsidiaries, Findlay, Ohio. The total overassessment allowed amounts to \$1,858,138.06 plus interest of \$804,136.87. Over one-half of the above overassessment is refunded and the remainder is credited. The years involved are 1916, 1917, and 1918.

The principal items the adjustment of which lead to the above overassessment are invested capital, depreciation, depletion, and the charging of drilling costs to expense in 1918. The decision of the commissioner is shown in Appendix 23. Certain comments by this division are shown in Appendix 24.

The only point we wish to discuss in this summary is in regard to charging drilling costs to expense. Article 223 of regulations 45 relating to the revenue act of 1918 states in part as follows:

ART. 223. *Charges to capital and to expense in the case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as an operating expense or charged to the capital account returnable through depletion. * * * An election once made under this option will control the taxpayer's returns for all subsequent years.

The above regulation, as it is being interpreted by the bureau, results in tremendous advantage to the oil and gas industry. In all other industries an expenditure is classed as a capital item or an expense item on the basis of fact. The controlling element in the determination of this fact rests on the continuance of a value due to this expenditure beyond the taxable year. In the oil and gas industry the opportunity is given to charge items which should be capitalized to expense.

Furthermore, the bureau now holds the opportunity existed for exercising the option in 1917, 1918, again in 1921, again in 1924 and again in 1926. Of course, the taxpayer in each instance takes the method giving the lowest tax.

Not only that, the taxpayer can capitalize all these items up to the high tax years thus increasing his invested capital, and for the following years charge the same kind of items to expense without revising his invested capital at the beginning of the year. In the case of a change from the accrual basis to the installment basis, this is not

allowed. When a taxpayer changes to the installment basis, he is required to go back into the past and reduce his invested capital on account of the change. It would be consistent to make the oil and gas industry do the same thing when changing their basis of expensing and capitalizing items.

In most cases the charging of items to expense did not reduce the depletion and depreciation allowed the taxpayer. The depreciation is reduced but the depletion is raised a like amount in the case of discovery value. This comes about on account of valuing oil wells by the method of future expected profits. The total value being fixed which is returnable through depreciation and depletion, it can be seen that a lowered investment in physical property through charging items to expense while decreasing the depreciation will correspondingly increase the depletion.

This division is of the opinion that regulation 45, article 223, above quoted would not stand the test in the courts, because there is no authority in the law giving the power to the commissioner to change capital items to expense items when the facts are available to controvert such a change. Moreover, the article 223 is distinctly discriminatory in character. This raises an interesting point. If the commissioner issues a regulation which is too liberal or erroneously in favor of the taxpayer, there is no one to contest this point in the courts. As a rule only regulations detrimental to taxpayers are made the subject of appeals to the courts. This suggests the propriety of an examination by the committee as to regulations which might appear to be uniformly too favorable to the taxpayer.

POSITION OF THE BUREAU

The position of the bureau, as set forth in the letters included in Appendices 24 (A) and (B), is:

The article in question has been in force for 10 years and has had the approval of three Secretaries of the Treasury and three Commissioners of Internal Revenue. Nevertheless, in view of the question raised by the staff of the committee, the Treasury is directing that a thorough survey of the problems, and the effect of the article be undertaken immediately. A general discussion of the article will be found in Appendix 24 (B).

The regulations have been applied properly in the instant case, as set forth in a letter included as Appendix 24 (A).

CASE NO. 21—DECEMBER

This is the case of the United States Steel Corporation and subsidiaries of New York City. The refund allowed amounts to \$15,756,595.72 plus interest of \$10,099,768.42. The only year involved is 1917.

The principal cause of the refund in this case is the recomputation of invested capital, although many important income adjustments are also made.

The joint committee considered this case on December 17, 1928. Subsequent to this meeting the following letter was sent to the commissioner which sums up the position of the committee:

DECEMBER 19, 1928.

HON. DAVID H. BLAIR,
*Commissioner of Internal Revenue,
Treasury Department, Washington, D. C.*

MY DEAR MR. COMMISSIONER: The Joint Committee on Internal Revenue Taxation at two sessions held on December 17, 1928, considered some of the problems involved in arriving at the tax liability of the United States Steel Corporation for the year 1917, with special reference to the computation of the consolidated invested capital.

After considering the statements of your representatives, the preponderant opinion of the members of the committee was that the committee should not interfere with your bureau in the determination made and the refund proposed.

The staff of the committee is still engaged in making certain mathematical checks of this case. If any questions arise in connection with such checks, they will be taken up in the usual way before the expiration of the 30-day period.

Very truly yours,

W. C. HAWLEY, *Chairman.*

This refund is the largest which has come before the joint committee. The following documents are attached in the Appendix:

Appendix 25. Letter to chairman with copy of commissioner's decision.

Appendix 26. Letter and memorandum of Treasury Department after hearing.

Appendix 27. Memorandum prepared by staff of committee prior to hearing, with chart and exhibits.

POSITION OF THE BUREAU

Inasmuch as the case has been reviewed by the joint committee and the position of the bureau adequately set forth in the attached exhibits, no further comment is deemed necessary.

CONCLUSION

As before noted, our comments on each case are followed by the "position of the bureau" after its examination of such comments. It does not appear necessary to reply to these statements except in three cases: In the Eisemann Bros. case (No. 12, June) the bureau takes the position that "the consistent interpretation of the bureau, based primarily upon the legislative history of the revenue acts, should not be reversed at this time." This argument does not appear convincing, as the consistent interpretation of the bureau for seven or eight years has often been reversed by the courts or by the Board of Tax Appeals. In the International Mercantile Marine Co. case (No. 4, November) Miss Matthews, of the general counsel's office, wrote an opinion that this adjustment should not be made. In the Ohio Oil case (No. 16, December), Mr. Gregg, former solicitor, refused the refund now allowed. It is apparent, therefore, that our disagreement with the final position taken by the bureau in these cases is not without reasonable basis, as there have been well-considered opinions rendered in the bureau which would sustain our objections.

While we have frankly criticized a number of the individual cases, this, of course, must be expected in view of the extreme complexity and intricacy of the law. Taken as a whole the refunds proposed by the commissioner show careful and proper handling in the face of many difficulties. Special assessment allowances have probably

been the most criticized. We understand that the bureau policy for the future will be very watchful as to the propriety of the allowances.

During the period June 1 to December 31, 1928, one case was withdrawn by the commissioner on account of an error pointed out by this division. This resulted in a saving of approximately \$193,000. The case is not included in the list in Part I as the refund was not paid.

Respectfully submitted.

L. H. PARKER,
Chief, Division of Investigation.

APPENDIX 1

CONGRESS OF THE UNITED STATES, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, *Washington, December 28, 1928.*

HON. WILLIS C. HAWLEY,
*Chairman Joint Committee on Internal Revenue Taxation,
Washington, D. C.*

MY DEAR CHAIRMAN: In accordance with your verbal request of yesterday, I am outlining briefly the procedure followed by this office in connection with the refunds and credits which have been or are being reported to the Joint Committee on Internal Revenue Taxation under the provisions of H. R. 16462, the urgent deficiency bill of February 28, 1927, and under the provisions of section 710 of the revenue act of 1928. The procedure followed was approved by Hon. William R. Green, former chairman of this committee.

Both the urgent deficiency bill and the revenue act of 1928 required that refunds and credits in excess of \$75,000 should be reported to the committee by the Commissioner of Internal Revenue, together with a copy of his decision in each case. No power to approve or disapprove these credits or refunds was vested in the committee. It was recognized, however, that while the committee had no definite responsibility in the matter of the refunds and credits, that nevertheless Congress had a purpose in enacting this legislation and that there was laid on the committee an obligation to carry out such purpose or purposes.

The purposes which it seemed probable that the Congress had in mind were the subject of conferences between the former chairman, Judge Green, and the writer. It was concluded that the intent of Congress could be analyzed substantially as follows:

First. It appeared to be the purpose that the joint committee should be informed as to the principal reasons for the crediting and refunding of taxes, and that the Congress should also be informed of such reasons if it was thought desirable.

Second. It appeared to be the purpose that the joint committee should be furnished currently with the decisions of the commissioner on these important cases, thus allowing it to study the effect of our system of internal-revenue taxation in the concrete instead of studying the effect of this system mainly in the abstract.

Third. It appeared to be the purpose that the committee itself, or its authorized agents, should call to the attention of the Bureau of Internal Revenue or the Treasury Department any final tax deter-

minations resulting in refunds or credits which might seem erroneous, or doubtful, or worthy of further study and investigation. It was understood, as the committee had no power to approve or disapprove of these matters, that the duty of the committee and its staff was discharged with the making of the above comments and that the department could act on same as it saw fit.

Judge Green instructed the writer to take charge of the reports made by the commissioner in regard to refunds and credits and to handle same in general conformity with the three purposes named above. It was realized that a complete audit of these cases could not be made, and it was therefore left to the discretion of the writer as to what cases would be especially investigated from the complete files of the Bureau of Internal Revenue. The reports made to the committee and the decisions of the commissioner have in all cases been carefully examined. Cases which have seemed doubtful after such examination have been thoroughly investigated on the doubtful points from the bureau files. Your instructions to the writer upon taking up the chairmanship of the committee were to follow the same procedure as instituted and approved by Judge Green.

In carrying out the above instructions the writer has had also two practical considerations in mind, first, to cause as little interference with the work of the bureau as possible, and, second, to cause no interest loss to the Government on account of delays.

Mr. Chesteen, assistant chief of this division and a former auditor of the consolidated returns division of the bureau, has immediate charge of all special investigations requiring an examination of the bureau files. He has been furnished, through the kindness of the commissioner, an office in the National Press Building, where the audit division of the bureau is located. Thus files can be examined by him or his assistant without leaving the building. This prevents many disadvantages which would occur if the files left the custody of the bureau for examination at the Capitol.

A few words seem proper as to the results of the above procedure. In carrying out what appeared to be the first purpose of the Congress in regard to ascertaining the principal reasons for the refunds and credits a complete report on refunds, credits, and abatements was made and furnished each member of the joint committee in January, 1928 (report dated December 8, 1927). This report fully outlines and classifies the principal reasons for such overassessments of tax and also contains a description of certain important individual cases and the comments made thereon to the bureau by this office. A duplicate copy of this report is attached. The joint committee took the matter of submitting this report to the Congress under advisement, and action thereon has not been taken. A similar report is now in process of preparation, and will be ready for submittal to the joint committee in January, 1929.

The second purpose which seemed to be in the mind of the Congress was in regard to furnishing a basis for the study of our system of internal-revenue taxation in the concrete in order that defects could be found and means of simplification arrived at. The writer believes that the study of these refunds has brought out matters which have had an important bearing on the following reports already made:

1. Depreciation.
2. Capital gains and losses.

3. Consolidated returns.
4. Interest.
5. Federal taxation of life-insurance companies. The necessity for reports on other subjects has also been seen from this study, among which may be mentioned:
6. Credit of foreign taxes.
7. Depletion.
8. Defects which allow of legal tax avoidance.
9. Valuation methods.

The third purpose of the Congress appeared to be that there should be an opportunity for comments to be made to the Treasury Department or the Bureau of Internal Revenue by the joint committee or its agents in regard to specific cases. It is the opinion of the writer that in the main the comments of this division have been helpful to the bureau instead of the reverse, as they have called to the attention of the higher officials certain doubtful issues, and, in at least one instance, seem to have corrected an inconsistent practice. The actual cases where the comments of this division have resulted in reducing the refunds proposed have only been two in number and the amounts saved comparatively small in comparison with the enormous amount of refunds made. Nevertheless, the corrections made have been in an amount more than sufficient to pay the expenses of this division since its organization.

The writer would be glad to be advised if the above sufficiently describes our procedure in connection with refunds and credits, and, also, if you desire to make any modifications or changes in our present practice.

Very respectfully,

L. H. PARKER.

APPENDIX 2

IN RE CHATHAM & PHENIX NATIONAL BANK, NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE, *May 28, 1928.*

Mr. COMMISSIONER: Certificates of overassessment of corporation income and profits taxes have been submitted for review in the case of the taxpayer named above as follows:

1918-----	\$91, 423. 61
1919-----	25, 224. 66
1920-----	1, 310. 76

The refunds are made under the provisions of section 284 (b), revenue act of 1926. For the year 1918 the refund represents part of an additional tax assessed in June, 1925, and paid June 29, 1925. For the year 1919 the total overassessment indicated is \$54,525.77; however, \$29,301.11 is barred by the statute of limitations and the refund represents additional taxes of \$2,487.36 assessed in March, 1923, and paid August 20, 1923, and \$22,737.30 assessed in September, 1925. The refund for 1920, represents part of an additional tax assessed in January, 1926. Claims for refund for 1918 and 1919 were filed in September, 1925. The claim is required for 1920 and no claim has been filed.

The allowances result from the redetermination of the profits taxes for 1918 and 1919 under the provisions of sections 327 and 328 of the revenue act of 1918. The claims based upon the application for such relief were filed subsequently to the assessment of additional taxes for 1918 and 1919 in accordance with the final order of the Board of Tax Appeals, after decision in the case of the taxpayer's appeal from deficiency letter dated August 7, 1924. The board's opinion is reported in Volume I, Board of Tax Appeals, page 460. Under the decision of the board, the net income for 1918 was increased \$262,571.01. This was due to adding to the 1918 income the unearned discount at December 31, 1917. It appears that prior to 1918, discount was reported as income in the year in which the note was discounted. On December 31, 1918, "unearned discount" was set up as a liability for the first time, thereby reducing income for 1918 and increasing 1919 income. In order to adjust this procedure, it was necessary to increase the 1918 income by the amount of the unearned discount at December 31, 1917.

Net income for 1919 was also increased under the final order of the board. The increase was \$72,521.94, representing an increase in the profit on the sale of certain bonds, the disallowance of excessive depreciation, and a slight increase in consolidated net income due to affiliation of two small corporations whose stock was owned by the taxpayer.

With respect to the redetermination of the profits tax, it appears that the basis, therefore, is the fact that taxpayer, during the years 1918 and 1919, had a large borrowed capital. Taxpayer's statutory capital was \$6,336,116.76 in 1918 and \$10,137,851.70 in 1919. During these years its average borrowed capital, evidenced by notes payable, amounted to \$6,137,000 in 1918 and \$12,786,708 in 1919. This money was all borrowed from the Federal reserve bank upon notes payable secured by collateral. This borrowed money was in addition to the amount of taxpayer's rediscounts with the Federal reserve bank. The taxpayer's average rediscounts were \$4,459,350.60 for 1918 and \$1,272,335.32 for 1919, but these rediscounts have not been considered as borrowed money. It appears that they were not a material income producing factor. The average amount of notes payable was approximately 96 per cent of statutory capital in 1918 and approximately 120 per cent of statutory capital in 1919. The evidence in the file indicates that it was customary for national banks to borrow money in this period but that the taxpayer's proportion of borrowed money to invested capital was greater than the average. The average proportion of borrowed capital as evidenced by notes payable to statutory capital of representative national banks with which taxpayer has been compared was 74 per cent in 1918 and 70 per cent in 1919. The borrowed money in question was borrowed by the taxpayer for no special purpose but merely for the general conduct of the business as the demand made necessary. It must be presumed that these large amounts of money borrowed and employed by the bank in its business earned a substantial part of the income which is being taxed and that without these borrowings it would have been impossible to have carried on the business as successfully and profitably as was the case.

This office has heretofore indicated that in a proper case borrowed money may be recognized as constituting an abnormality within the

meaning of section 327 (d). (See L. O. 1109, C. B. I-2, p. 253, where the former solicitor included as a typical and common case where there is present an abnormal condition affecting capital or income the case where the capital employed, although a material income producing factor, is very small or is in a large part borrowed. See also Appeal of Standifer Construction Co., 4 B. T. A. 525, commissioner's acquiescence, C. B. V-2, p. 3, and Appeal of Saner-Ragley Lumber Co., 3 B. T. A. 927, commissioner's acquiescence, C. B. V-1, p. 5.)

It appears that the constructed invested capital based on the final profits tax as redetermined under section 328 is in an amount that does not exceed the statutory capital increased by the percentage by which taxpayer's percentage of borrowed capital to statutory capital exceeds the average. Thus, the relief given does not extend beyond the correction of the abnormal condition which has been established.

The taxpayer has been compared with representative concerns, all of them national banks, which are as nearly as may be similarly circumstanced with respect to gross income, net income, capital employed, and all other relevant facts and circumstances. The effect of the redetermination of the profits taxes is indicated as follows:

	Section 301	Section 328
1918		
Net income.....	\$1,030,539.00	\$1,030,539.00
Profits tax.....	\$295,424.00	\$191,533.27
Per cent profits tax to net income.....	28.66	18.59
1919		
Net income.....	\$2,232,493.00	\$2,232,493.00
Profits tax.....	\$324,677.00	\$260,099.81
Per cent profits tax to net income.....	14.54	12.05

The allowance for 1920 is due to the revision of the invested capital consequent upon the revision of the taxes for 1918 and 1919.

In view of the foregoing it is recommended that the overassessments indicated above be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 2(A)

IN RE CHATHAM & PHENIX NATIONAL BANK

JUNE 15, 1929.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: In connection with the allowance of an over-assessment in favor of the above-named taxpayer, the following information is submitted, particularly in connection with the observation made in your staff report in regard to the bureau policy of reopening cases after the board has rendered an opinion.

It will be recalled that the United States Board of Tax Appeals was created by section 900 of the revenue act of 1924. It was not given jurisdiction to find overpayments. The findings of the board were not final or conclusive but were only "prima facie evidence of the facts therein stated." The act admittedly contemplated concurrent or subsequent prosecution of claims for refund elsewhere. (Secs. 281 and 1014 of the 1924 act.) The undesirability of this dual prosecution of two phases of a single case was pointed out to the Congress by the Treasury, the American Bar Association, and others during the consideration of the revenue act of 1926, and important changes in the jurisdiction of the board and the legal effect of its decisions were enacted.

The legal effect of the provisions of the 1926 act is to require taxpayers who petition the board after the enactment of that act to present their entire case to the board and obtain a determination by the board of their entire tax liability for the year involved. However, the provision restricting the prosecution of claims for refund or credit is specifically made inapplicable to cases in which the petition was filed prior to the enactment of the 1926 act. The statutory provisions and their legislative history indicate conclusively that Congress did not desire to remove the possible dual presentation of issues in cases pending before the board upon the date of the enactment of the 1926 act.

As a matter of administrative policy the commissioner decided, shortly after the enactment of the revenue act of 1926, that notwithstanding his admitted power, he would not reopen cases decided by the board in which the petition was filed prior to the enactment of the 1926 act, except with his specific approval. This policy has been adhered to, and it is believed that no reasonable doubt as to the propriety of the refund exists in any of the cases which have been reopened.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 3

IN RE COLE MOTOR CAR CO., INDIANAPOLIS, IND.

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, July 12, 1928.

MR. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above-named taxpayer for the years 1918 to 1921, inclusive. The over-assessment results from the allowance, in a large measure, of relief under sections 327 and 328 of the revenue act of 1918.

The Cole Motor Car Co., at the date of incorporation, resulted from a reorganization of a predecessor company, stock being exchanged for stock of the old company. It is claimed that the predecessor com-

pany was possessed of a substantial amount of good will and, at the time of reorganization, had perfected a car which had a wide distribution.

The data submitted in the case tends to establish that an abnormality was created as a result of the reorganization, which brings the case within the provisions of sections 327 and 328 of the revenue act of 1918, and, since the comparatives appear to be reasonable, it is recommended that no objection be offered to the proposed refund.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 4

IN RE EISEMANN BROS., BOSTON, MASS.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
May 26, 1928.

Mr. COMMISSIONER: A certificate of overassessment of profits taxes in the amount of \$193,072.08 in favor of the above-named partnership for the 9-month period ended December 31, 1917, has been submitted for review.

The overassessment is due to the determination of the profits tax of this partnership under the provisions of section 210 of the revenue act of 1917. The allegation of abnormality recognized by this office and the Income Tax Unit as entitling the taxpayer to the determination of its liability for profits tax under the provisions of that section of the act is that the capital employed, although a material income-producing factor, is in a large part borrowed.

A claim for refund of taxes referred to was filed July 21, 1924, a waiver which this office had previously considered and determined to be valid having previously been filed and approved by the commissioner on January 20, 1923. Therefore, in accordance with the provisions of section 284 (g) of the revenue act of 1926, the overassessment of taxes determined for the 9-month period ended December 31, 1917, may be properly refunded.

The partnership is engaged in buying and selling wool and is referred to as a wool merchant. This partnership began business on April 1, 1917, having succeeded to the business theretofore conducted by a partnership also known as Eisemann Bros., but composed of different individuals and which had been in business many years. The formation of the new partnership was necessitated by the withdrawal of one of the members of the predecessor partnership and the addition of two new members. The fact that although the instant partnership was of recent formation but was enabled to borrow large sums of money is doubtless attributable to the fact that it was but a continuation of a previous existing partnership trading under the same name, the principal partners of which were also members of the taxpayer partnership.

During the period under review the taxpayer had gross sales of \$10,738,380 and a net income of \$2,046,019.67. The statutory invested capital employed was \$1,736,738, and the excess-profits tax computed under the provisions of section 207 of the revenue act of 1917 was \$1,070,405, or 52.32 per cent of its net income. In the

return as filed the taxpayer claimed a deduction of \$108,867 for interest paid on money borrowed. The taxpayer has submitted a brief dated December 23, 1926, in which approximately 60 different loan transactions are set forth in detail showing dates and amounts borrowed, from whom borrowed, and indicating an average borrowing for the period of approximately \$2,826,000. Therefore, the borrowed capital as alleged by the taxpayer represents approximately 163 per cent of the statutory invested capital. The Income Tax Unit determined the average borrowed capital employed in the business to have been \$2,257,759, or approximately 130 per cent of the statutory invested capital.

A review of the data sheet prepared by the Income Tax Unit reveals that the comparatives used are fairly comparable considering invested capital, gross sales, and cost of sales, but that there is a marked difference in the amount of borrowed capital employed by the comparative concerns. The maximum amount of borrowed capital employed by any of the comparative businesses is 89 per cent and the average for the group is about 53 per cent. When it is considered that this taxpayer employed borrowed capital in excess of 130 per cent in its business it is obvious that an abnormal condition existed when compared with representative concerns. The marked variance in borrowed capital employed may therefore be said to, in a large degree, explain the difference between the ratio of net income to invested capital of this taxpayer of 117 per cent as compared with an average of 70 per cent for the comparative concerns. It is therefore apparent that the taxpayer earned a proportionately very much higher net income as compared with its invested capital than the comparative concerns.

This office, in Law Opinion 1109, published in C. B. 1-2, at page 253, recognized that an abnormality entitling taxpayers to the determination of their profits tax under sections 327 and 328 of the revenue act of 1918, may exist "where the capital employed, although a material income-producing factor, is very small or is in a large part borrowed."

The question of whether this taxpayer is entitled to have its profits tax for the nine months' period ended December 31, 1917, computed under the provisions of section 210 of the revenue act of 1917 has been previously considered by this office and made the subject of a memorandum to the Income Tax Unit under date of February 14, 1928. After a careful consideration of the facts involved in the case this office held that the taxpayer was entitled to have its profits tax computed under the provisions of that section of the act and so recommended to the unit in its memorandum of that date and since, under Law Opinion 1109 where borrowed capital is a material income-producing factor, it is recognized as an abnormality and as it appears that the borrowed capital employed by this taxpayer was a material income-producing factor, the decision of this office that the taxpayer was entitled to have its profits tax computed under the provisions of section 210 of the revenue act of 1917 appears correct.

The effect of determining this taxpayer's profits tax liability for the nine months' period ended December 31, 1917, under the provisions of section 210 of the revenue act of 1917 is indicated in the following schedule:

Period ended Dec. 31, 1917:

Profits tax liability—	
Under section 201.....	\$1, 070, 405. 00
Under section 210.....	877, 333. 24
Ratio of profits taxes to net income:	
Under section 201.....	52. 32
Under section 210.....	42. 88

In accordance with the foregoing it is recommended that the over-assessment appearing above be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: May 29, 1928.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 5

JULY 12, 1928.

Mr. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury,
Washington, D. C.

DEAR MR. ALVORD: Please find inclosed copy of a report from Mr. G. D. Chesteen, corporation auditor for this committee in regard to the overassessment proposed in the case of Eisemann Bros., Boston, Mass. This case was submitted to the committee on June 25, 1928, and the 30-day period will expire on July 25.

The overassessment in this case is due entirely to the allowance of special assessment under section 210 of the revenue act of 1917. The ground for the allowance is excessive borrowed capital.

It is the opinion of Mr. Chesteen, concurred in by the writer, that excessive borrowed capital does not constitute a ground for special assessment in the year 1917, and that this opinion is sustained by the Board of Tax Appeals decisions, and the position taken by the appeals division of the general counsel's office.

It is requested that due consideration be given to the points raised in Mr. Chesteen's report before the refund or credit occasioned by this overassessment is finally made. As 13 days remain before the 30-day period expires, and as there is practically only one issue involved, it appears certain that ample time is available for such consideration without causing loss of interest to the Government.

Very truly yours,

L. H. PARKER.

IN RE EISEMANN BROS., BOSTON, MASS.

JULY 11, 1928.

Mr. L. H. PARKER,
Chief Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above-named partnership for the period April 1 to December 31, 1917, in

the amount of \$193,072.08, as shown by certificate of overassessment No. 731519. The results of the examination are set forth below:

FACTS

The above-named partnership is engaged in buying and selling wool, and is commonly referred to as a wool merchant. The business began April 1, 1917, having succeeded to the business theretofore conducted by a partnership also known as Eisemann Bros., but composed of different individuals, one of the Eisemann brothers having withdrawn on April 1, 1917. In lieu of his interest in the business, two additional partners with their small investments were admitted to the new partnership.

During the period under review, the taxpayer had gross sales of approximately \$10,783,380 and a net income of \$2,046,019.67. Statutory invested capital employed was \$1,736,738, and the excess-profits tax, computed under the provisions of section 207 of the revenue act of 1917, was \$1,070,405, or 52.32 per cent of its net income.

The taxpayer laid claim to relief under section 210 of the revenue act of 1917 on two grounds: First, low officers' salaries; second, borrowed capital. The case was considered a number of times by the unit and rejected. During these discussions, the file apparently was referred to the office of general counsel where, it appears, rejections were made under dates of October 27 and December 6, 1926, and October 10, 1927. After these rejections, it appears the case was referred for the fourth time to the office of general counsel, resulting in a decision by that office to the effect that the taxpayer should be given the benefit of section 210 of the revenue act of 1917. This decision is dated February 2, 1928.

OPINION

The memorandum of the claim division of the office of general counsel approving the overassessment reads, in part, as follows:

This office in law opinion 1109, published in C. B. 1-2, at page 253, recognized that an abnormality entitling taxpayers to the determination of their profits tax under sections 327 and 328 of the revenue act of 1918, may exist "where the capital employed, although a material income-producing factor, is very small or is in a large part borrowed."

The question of whether this taxpayer is entitled to have its profits tax for the nine months period ended December 31, 1917, computed under the provisions of section 210 of the revenue act of 1917 has been previously considered by this office and made the subject of a memorandum to the Income Tax Unit under date of February 14, 1928. After a careful consideration of the facts involved in the case this office held that the taxpayer was entitled to have its profits tax computed under the provisions of that section of the act and so recommended to the unit in its memorandum of that date and since, under law opinion 1109 where borrowed capital is a material income-producing factor it is recognized as an abnormality and as it appears that the borrowed capital employed by this taxpayer was a material income-producing factor, the decision of this office that the taxpayer was entitled to have its profits tax computed under the provisions of section 210 of the revenue act of 1917 appears correct.

In both the memorandum quoted above and in the opinion of the office of general counsel, dated February 2, 1928, allowance of special assessment is based solely upon the grounds of borrowed capital. The writer is unable to concur in the opinion of the office of general counsel, as quoted above, and gives his reasons for exception, as follows:

Section 210 of the revenue act of 1917, on which the office of general counsel relied in recommending the overassessment in this case, reads in part, as follows:

That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year. * * *

It should be noted from the foregoing statute, the only ground for special assessment under the revenue act of 1917 is that the Secretary of the Treasury is unable in any case satisfactorily to determine invested capital. The invested capital has been accurately determined in this case and no contention has been made by the taxpayer to the contrary. There is no intimation, on the other hand, in the opinion rendered by the office of general counsel, that statutory invested capital has not been accurately determined. In view of this conclusion, the writer is constrained to hold that the recommendation made by the office of general counsel is erroneous and not based upon the statute.

The United States Board of Tax Appeals, has in a series of cases, interpreted section 210 of the revenue act of 1917. In the case of the Noonan Coal Company *v.* Commissioner (9 B. T. A. 835) one of the issues involved was special relief under section 210 of the revenue act of 1917. In the petition of that case, there was a general statement that the commissioner erred in not computing the tax under section 210 and no specific averment that the invested capital could not be determined. The board said, in disposing of this question, "We are of the opinion that the evidence does not establish that the invested capital can not be satisfactorily determined and a determination of the tax under section 210 is not warranted."

In an earlier case, the case of the Appeal of the United Shoe Stores Co. (2 B. T. A. 73), the question of relief under section 210 arose. The ground for special assessment apparently was inadequate officers' salaries for the year 1917. The board said, in disposing of this case:

Section 210 provides additional relief in cases where the Secretary of the Treasury is unable satisfactorily to determine invested capital. The taxpayer does not fall within any of these provisions.

The board took the same position in the case of the West End Consolidated Mining Co. (3 B. T. A. 128), and said, in this decision in referring to section 210 of the revenue act of 1917:

This section provides only *one ground* for special relief, namely, that the Secretary of the Treasury is unable satisfactorily to determine the invested capital. * * * There is nothing in the history of this section to which our attention has been called or which we have been able to find which would extend the scope of the section *beyond its words*.

It may be argued, however, that the commissioner found it impracticable to follow literally section 210 of the revenue act of 1917, and laid down regulations broadening its scope, and that the decision of the general counsel is based upon these regulations as interpreted by section 1109. This argument, however, would be without merit, as shown by a recent case (not yet decided) before the United States Board of Tax Appeals; namely, the Duquense Steel Foundry Co. (Docket No. 5217.) In this decision the board had before it claim

for special assessment based on section 210 of the revenue act of 1917, among the issues being low officers' salaries and borrowed capital. Mr. Backstrom, attorney for the appeals division of the office of general counsel, objected to the evidence offered by the petitioner in this case in substantiation of its claim for relief on account of officers' salaries and borrowed capital, on the grounds that the board, in a series of cases previously decided, had held that section 210 of the revenue act of 1917 was applicable only to cases wherein the commissioner was unable to determine the invested capital. The member, after looking into the references cited, sustained the objection of the attorney for the Government in this case. The member during these hearings, ruled particularly on article 52 of regulations 41, which interprets section 210 of the revenue act of 1917. The pertinent part of the hearings in which Mr. Knox, attorney for the petitioner, argued in defense of the regulations, and the holding of the member, is here quoted:

MR. KNOX. Nobody knew what that section meant when it came up for actual administration, and the result was the Treasury Department adopted certain rules and regulations and made certain decisions under that act, and broadened the scope of it, and when Congress came to pass the act of 1918, they embodied in that act the interpretation which the Treasury Department had put on the act of 1917.

THE MEMBER. A study of the reports of the congressional committees might or might not show that to be a fact, but we do not have that before us as established, and that is a very unsafe rule to adopt. The other angle to look at is, Congress having seen that the present law is inadequate and does not accomplish the ends desired, enacts a new law to remedy the defects and to cure the inequities of the previous law, but that does not relieve any case brought under the previous law; that merely follows by way of interpretation for amelioration of cases under the new law.

MR. KNOX. But is it not also true that where a law has been interpreted in a certain way by the Treasury Department repeatedly, the court will adopt that interpretation which the Treasury Department itself has put upon that law?

THE MEMBER. That has often been said. Where a long-establish practice is shown and where it is something within the power of the department to determine upon, they will not upset it; but here there seems to be *one definite ground* set down as a basis for special relief. I do not recall having considered any cases involving this identical question myself, but the cases that counsel for the respondent has cited seem to me to be sufficient to establish his point."

The member, in finally disposing of the question, commented as follows:

Of course, we aim to look at the intent behind the law, but we have to avoid the other extreme of legislating by decision, and that is what I fear we would be doing in this case to permit the testimony as laying the ground for relief along the lines you have asked. The objection will be sustained.

In view of the foregoing decisions by the United States Board of Tax Appeals, it is apparent that the commissioner has objected to the allowance of special assessment for the year 1917 on the grounds of borrowed capital in other cases before the United States Board of Tax Appeals, and that this objection on the part of the commissioner has been sustained by rulings of that body. The writer, therefore, can find no reason for proposing a refund in this case on a basis which the Board of Tax Appeals has previously held was not authorized in section 210 of the 1917 act and which appears to be contrary to the practice of the appeals division in presenting cases now in controversy before the board and before the courts. It is also pointed out that law opinion 1109, quoted by the general counsels' office, applies to the 1918 and subsequent acts, and not to the 1917 act.

There is a further observation, although not a legal basis for objecting to the proposed refund, but certainly a good argument from the standpoint of abstract justice. The refund in this case is approximately \$193,000, and, under rules and regulations governing the computation of the distributive shares to each of the partners, the reduction of the tax to the partnership results in a similar increase in income to the members of the partnership. It seems that further additional assessments on the individuals are barred by the statute of limitations. It is not practical, without examining the individual returns, to say just how much additional tax would be lost to the Government by making the refund here proposed and, at the same time, not be able to assert the deficiencies due from the individuals, but, judging from the distributive shares of the members, the tax would be at least \$50,000.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

SCHEDULE A

Original and adjusted balance sheets, December 31, 1917

	Books	Adjusted	Differences
ASSETS			
Cash.....	\$1, 586, 382. 99	\$1, 586, 382. 99	-----
Accounts receivable.....	1, 132, 066. 78	1, 132, 066. 78	-----
Inventories.....	2, 170, 814. 62	2, 170, 814. 62	-----
Furniture and fixtures.....	2, 000. 00	2, 102. 82	\$102. 82
Liberty bonds.....	90, 000. 00	90, 000. 00	-----
Total.....	4, 981, 264. 39	4, 981, 367. 21	-----
LIABILITIES			
Accounts payable.....	165, 679. 65	165, 679. 65	-----
Bills payable.....	1, 055, 000. 00	1, 055, 000. 00	-----
Reserve for taxes.....	1, 173, 119. 82	1, 173, 119. 82	-----
Net worth.....	2, 587, 464. 92	2, 587, 567. 74	102. 82
Total.....	4, 981, 264. 39	4, 981, 367. 21	-----

Difference of \$102.82 shown against furniture and fixtures is an adjustment of depreciation to bring the value of this item per books into agreement with the value shown on the schedules of depreciation which appear on the last page of this report.

Reconciliation of net worth, original

Net worth, books, Apr. 1, 1917.....	\$1, 727, 736. 55
Additional capital introduced.....	22, 000. 00
Interest credited to capital accounts.....	51, 263. 27
Salaries credited to capital accounts.....	107, 000. 00
Net profit, books.....	933, 347. 51
Total.....	2, 841, 347. 33
Less: Withdrawals.....	253, 882. 41
Net worth, books, Dec. 31, 1917.....	2, 587, 464. 92

APPENDIX 6

TREASURY DEPARTMENT,
Washington, October 15, 1928.

Mr. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

DEAR MR. PARKER: Prior to my departure for the National Tax Association meeting I explained to you over the telephone the position of the Treasury upon the proposed refund in the case of Eisemann Bros., Boston, Mass., consideration of which was requested in your letter of July 12. The single question is presented as to whether or not excessive borrowed capital is a proper ground for the allowance of special assessment under section 210 of the revenue act of 1917. I explained that the Treasury was of the opinion that excessive borrowed capital was a proper ground for the allowance, that the proposed refund should be paid, and that inasmuch as time limitations necessitated it a written reply to your inquiry would be postponed until my return to Washington.

Upon the receipt of your letter a conference of Treasury officials was called, at which there were present, among others, Assistant Secretary Bond, Mr. Charest, the general counsel of the Bureau of Internal Revenue, Mr. Mires, the assistant to the Commissioner of Internal Revenue, Mr. Kinsel, chief of special assessment section, and myself. The question was discussed at length, and, as I stated above, it was decided that excessive borrowed capital is a proper ground for the allowance of special assessment under the 1917 act, and that the long-continued practice of the bureau should not be changed.

As you know, the question is not a new one, nor is its solution free of difficulties. I believe, however, that if you could now place yourself in the position of those responsible for the legislation and for the administrative determinations immediately following the enactment of the revenue acts of 1917 and 1918, you would concur in the decision. I have attempted to piece together, from the legislative history of the two acts, the records of the bureau, oral conversations with those who were in the bureau at that time, and oral conversations with those taking part in the legislation, particularly Doctor Adams, who, as you know, represented the Treasury, the relation between the 1917 act and the 1918 act upon the question.

It seems to be admitted generally that the provisions of section 327 of the revenue act of 1918 were based upon the regulations and practices of the bureau under section 210 of the revenue act of 1917. The regulations under the 1917 act (par. (4) of article 52 of Regulations 41) specifically extended the provisions of section 210 beyond inability "satisfactorily to determine the invested capital," and specifically provided for the application of section 210 in cases where "the invested capital is seriously disproportionate to the taxable income." Again, excessive borrowed capital was, prior to and during the consideration of the revenue act of 1918 by Congress considered in specific cases as a proper ground for special assessment. The regulations and the practices were explained to the Committee on Ways and Means and the Committee on Finance, and the enactment of

section 327 of the 1918 act was accepted as a legislative ratification of them. Under these circumstances, it is not surprising that the decisions under section 327 have always been considered as applicable to section 210 and this has probably occasioned the erroneous impression that section 327 has been applied retroactively.

I have examined the decisions of the Board of Tax Appeals upon the question, and, in the opinion of the Treasury, they do not hold that the Treasury's position is erroneous and that excessive borrowed capital is not a ground for granting special assessment.

Even assuming, however, that the question might well be susceptible of a different answer as an original proposition, it was the unanimous opinion of those attending the conference that the Treasury would not be justified, as a matter of policy, in changing the practice which has been followed since the enactment of the 1917 act, in the absence of a compelling court decision. Such change would be exceedingly unfair to those taxpayers whose cases had not yet been closed and would discriminate unjustly against them and in favor of their competitors who were more fortunate in succeeding in the closing of their cases.

I trust that this letter will prove sufficient and, as usual, I will be very glad to discuss the matter with you further, should you desire.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 7

IN RE P. LORILLARD CO., NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
May 8, 1928.

MR. COMMISSIONER: A certificate of overassessment of corporation income and profits taxes has been prepared in favor of the above-named company for the year 1918 in the amount of \$1,231,006.78.

The taxpayer filed an original return for 1918 income and profits tax liability of \$1,407,346.13 which amount was assessed. In May, 1920, an additional tax liability was assessed in the amount of \$3,602,971.81 based upon an office audit in which a deduction claimed on the original return for loss in inventories was disallowed. Other adjustments were made in the audit of the case at this time but the reversal of the inventory deduction accounted for practically the entire additional tax assessed. Subsequently, in an audit based upon a field examination the tax liability indicated in the prior office audit was reduced and a refund was made in the amount of \$265,035.38. The income and capital forming the basis for the determination of tax liability resulting in this overassessment afford the starting point for the present audit of the case. The income shown in the prior audit has been reduced in the present audit of the case, by the allowance of additional depreciation in an aggregate amount of approximately \$115,000. This reduction in income has been partially offset through the restoration of taxable Liberty bond interest in the amount of \$56,114.58. A portion of the present overassessment is therefore

due to the net reduction in income of approximately \$59,000. The remainder of the present overassessment is entirely due to the allowance of assessment under the provisions of sections 327 and 328 of the revenue act of 1918.

It is noted, however, that an audit on a statutory basis indicates an overassessment of \$97,215.26 which overassessment is partly due to the reduction in income above noted and partly due to a readjustment of the pre-war net income and pre-war invested capital. In view of the fact that special assessment is allowed, the changes to pre-war income and pre-war capital have no effect as the profits-tax liability is computed on the basis of comparison with representative concerns and not under the provisions of sections 310, 311, 312, 326, etc., of the revenue act of 1918. Since the allowance of special assessment renders the adjustments to pre-war capital and income immaterial they are not explained herein. The effect of the allowance of special assessment is indicated in the following schedule:

Year 1918:

Net income.....	\$10, 074, 424. 88
Profits-tax liability—	
Section 301.....	3, 916, 034. 00
Section 328.....	2, 627, 634. 75
Percentage ratio, profits tax to net income—	
Section 301.....	38. 86
Section 328.....	26. 08

The taxpayer indicated a number of abnormal conditions in its claim for special assessment. Of these all have been rejected except two, and these two are conceded by the Income Tax Unit as forming the basis for the allowance of assessment under the provisions of section 328 of the revenue act of 1918. The first abnormality cited by the taxpayer arises in connection with advertising expenditures which, it is claimed, were charged in error on its books to expense instead of having been allocated between capital and expense in the proportion which they secured new business and retained current business.

In support of a basis for such an allocation the taxpayer compiles sales, advertising expenses and profits by brands for the years 1913 to 1918 inclusive. This schedule indicates that losses were sustained during the first three years on sales of new brands and that the advertising expenses in connection with these brands were very large. The sales of these new brands increased during the years 1913 to 1918 from \$9,000,000 to \$23,000,000. The advertising expenses decreased from \$1,300,000 to \$860,000. Advertising expenses in connection with sales of old brands remained practically stationary over this period and the sales of old brands were practically level and from these facts the taxpayer contends that the Income Tax Unit could determine the proportion of advertising expenditures which should have been capitalized and the proportion which should have been charged to expense. While the Income Tax Unit has been unable to concede that the proportion of capital expenditures can be segregated from the advertising costs from the information submitted by the taxpayer, it is quite evident from the history of the expenditures in connection with new brands and old brands that a substantial portion of the advertising cost represents a capital expenditure and should not have been charged to expense by the taxpayer. In the absence of any satisfactory method of allocating these expenditures between capital

and income the Income Tax Unit has held that the statutory invested capital can not be properly determined.

The taxpayer has also claimed as a second basis for the allowance of special assessment that the invested capital was abnormal in that it operated largely upon borrowed capital. The statutory invested capital of the taxpayer during the year under review was \$37,408,398, and the average borrowed capital computed on the basis of capitalizing the interest deduction exceeded \$35,000,000. This figure is substantiated by an average of the monthly balances of outstanding interest bearing indebtedness. The borrowed capital, therefore, approximated 94 per cent of the statutory invested capital during the year under review. The taxpayer employed a proportion of borrowed capital far in excess of the average for the industry. The employment of this excessive borrowed capital brings the taxpayer within the type of cases held to be abnormal in L. O. 1109, published C. B. I-2-606. It is therefore believed that this use of an excessive borrowed capital constitutes an abnormal condition in the taxpayer's statutory invested capital within the purview of Section 327 of the revenue act of 1918 and warrants the allowance of assessment under the provisions of section 328 of the revenue act of 1918.

The taxpayer is one of the four tobacco-products concerns that dominate the entire field in the United States. The other three concerns are the American Tobacco Co., Liggett & Myers Tobacco Co., and the R. J. Reynolds Tobacco Co. While there are a number of smaller concerns, these smaller concerns taken together do not market 5 per cent of the total tobacco products sold in the United States. Of these principal tobacco producers, the R. J. Reynolds Co. has been granted special assessment and a report of the allowance to that company was made to the Joint Congressional Committee on Internal Revenue Taxation under date of June 7, 1927. In the allowance of special assessment to that company the profits tax was based upon a comparison with the profits tax paid by the Liggett & Myers Co. The American Tobacco Co. was not used as a comparative company due to the fact that its statutory capital was abnormally high and its rate of profits tax to net income lower than an amount deemed to be clearly representative of the tax paid in the industry.

In the selection of comparative concerns in the present case the same difficulties were encountered as in the selection of comparatives for the R. J. Reynolds Tobacco Co. The Income Tax Unit has prepared a data sheet using the Liggett & Myers Co. as a comparative. As this company is the only concern not granted special assessment and of comparable size to that of the taxpayer, this action appears entirely proper. It is practically impossible to find other concerns that may be used at all. If the smaller concerns were considered to be comparable, their employment in the preparation of a data sheet would not materially affect the final rates of tax liability as the data sheet would continue to be dominated by the Liggett & Myers Co. Further, the use of the smaller concerns which are clearly not comparable in regard to size of business, manner of operation, etc., would practically force the use of the American Tobacco Co. with its tremendous capital and profits tax of approximately 16 per cent of net income. The preparation of such a data sheet would materially lower the final rate of profits-tax liability with a result of a lower rate for the taxpayer than that now obtained. In view of all the facts it is,

therefore, believed that the Income Tax Unit in the preparation of the present data sheet using Liggett & Myers as the sole comparative has followed the real meaning and intent of section 327 of the revenue act of 1918. The data sheet as now prepared lists a comparative company engaged in the same or closely related business to that conducted by the taxpayer, a concern of comparable size to the taxpayer and one that is as nearly as may be similarly circumstanced to the taxpayer with respect to gross income, net income, profits per unit of business transacted, and all other relevant facts and circumstances.

In view of the foregoing it is recommended that the certificate of overassessment above indicated be allowed.

C. M. CHAREST,
General Counsel Bureau of Internal Revenue.

Approved: May 9, 1928.

D. H. BLAIR,
Commissioner of Internal Revenue.

APPENDIX 7 (A)

IN RE P. LORILLARD CO., NEW YORK, N. Y.

TREASURY DEPARTMENT,
Washington, June 12, 1929.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: Reference is made to your letter dated July 12, 1928, concerning the above-indicated case.

It may be said at the outset that the Division of Investigation has evidently overlooked the fact that the matter of special assessment in the Reynolds Tobacco Co. case was subject to review by the Board of Tax Appeals, where it was then pending, since the case involved unpaid additional assessments as well as refunds. The Supreme Court decision in the case of the Williamsport Wire Rope Co., to which the Division of Investigation refers is not, therefore, applicable to the Reynolds Tobacco Co. case which is governed by the decision of the same court in the case of *Blair v. Oesterlein Machine Co.* (275 U. S. 220). The first-named decision negatives the right of review of special-assessment cases by the courts in the absence of fraud or other irregularities, while the latter decision approves such a review by the Board of Tax Appeals.

The case of P. Lorillard Co., so far as a review of the commissioner's action in the case is concerned, is governed by the Williamsport Wire Rope decision since the company had no right to appeal to the board. One view of the Williamsport Wire Rope decision would be that the commissioner is now in a position to deny all special-assessment claims or to act arbitrarily with respect thereto where the taxpayer has no right of appeal from the commissioner's findings. But it is not believed that, as a matter of equity and good faith, any different policy should be followed in this type of case than is followed in a case where the commissioner's finding is subject to review

by the board. In this connection it should also be remembered that the Supreme Court reserved the right to consider a refund case involving irregularities in the commissioner's administration of the special-assessment provisions of the law. Certainly the Supreme Court did not intend to recognize that the commissioner in exercising his discretion could refuse to grant special assessment in all refund cases under authority of the Williamsport Wire Rope decision and allow special assessment only in deficiency cases under authority of the Oesterlein Machine Co. decision.

You have asked that the bureau consider changing its policy so as to deny special assessment in cases such as those of the Reynolds Tobacco Co. and P. Lorillard Co. where no exceptional hardship is proven and where the taxpayer has no appeal from the commissioner's action. This seems to go more to a matter of judgment in such cases rather than to a change of policy, since if the bureau does not believe that a cause for special assessment is proven, it will not allow special assessment in the first instance. For the reasons above stated, it is not believed that a taxpayer claiming a refund should be treated differently in matters of special assessment from one claiming a reduction in a tax deficiency.

When the Reynolds Tobacco Co. case was under consideration it was decided that the decision of the Board of Tax Appeals in the case of Northwestern Yeast Co. (5 B. T. A. 232) was direct authority for the allowance and the board has since applied the same principles upon which it decided this case in later decisions. (See Colonial Ice Cream Co., 7 B. T. A. 154; George W. Caswell Co. v. Commissioner, 14 B. T. A. 15. These decisions are also in accordance with long-established bureau practice as expressed in A. R. M. 12, C. B. V., p. 292 and A. R. M. 141, C. B. V., p. 296.) It was also found that the P. Lorillard Co. was entitled to special assessment under these same board decisions and bureau rulings and that in addition a cause for special assessment existed because of the large amount of borrowed capital employed by the company in its business. (See Standifer Construction Co., 4 B. T. A., 525; E. B. Ficklen Tobacco Co. v. Commissioner, 10 B. T. A. 51 and L. O. 1109, C. B. I-2, p. 253.)

The staff of the joint committee previously questioned the use by the bureau of one comparative company in adjusting the Reynolds Tobacco Co. case and has since raised the same question in the P. Lorillard Co. case. In the Reynolds case the taxpayer was arguing for the use of a certain other company which the bureau questioned as being a proper comparative but at the same time conceded that there was considerable doubt as to whether it should not be used and also whether it would not in fact be used if the case were tried before the board. If this company had been used as a comparative the refund which the bureau was willing to approve would have been increased several million dollars. There were also several other companies much smaller in size than the taxpayer which, if used as comparative companies, would have decreased the refund by \$200,000 or \$300,000 and other smaller companies which, if used, would have increased the refund by approximately the same amount. Although both the Government and the taxpayer were agreed that the single company proposed by the Government was representative of the taxpayer and a good comparative within the meaning of section 328 of the revenue act of 1918, there was considerable dispute as to

whether the smaller companies or the other large company advanced by the taxpayer met the requirements of section 328. It was the opinion of those representing the Government that if they had insisted on the use of the smaller and less representative companies which would have raised the tax that the representative of the taxpayer could and would as logically and properly have insisted on the use of another group of the same type of companies which would have lowered the tax, and also it was realized that if there was a departure from the use of the one admitted representative company the taxpayer's claim for the use of the other larger company would be strengthened.

It is obvious that each special assessment case by its nature presents its own individual problem with respect to the selection of comparative companies. The Reynolds case was finally adjusted agreeably to each party and under the circumstances of the case it is believed that the use of one comparative was justified. There would probably have been no objection on the part of either party to the use of some of the smaller companies as comparatives without effect on the result reached through the use of one comparative. Although this would probably have met the technical objection raised by the staff of the joint committee, the use of these additional companies would have been a useless gesture and of no practical effect.

The situation in the Lorillard case with respect to the selection of comparative companies was the same as that found in the Reynolds case. That is, after extended arguments the company agreed to close the matter by the use of one comparative (the same as the one used in the Reynolds case) which was admittedly a representative company and to the exclusion of others whose use was admittedly doubtful. It is believed that the use of one comparative company was justified in this case for the same reason that it was justified in the Reynolds case.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 8

IN RE THE TRIBUNE CO., CHICAGO, ILL.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
May 28, 1928.

Mr. COMMISSIONER: Certificates of overassessment have been prepared in favor of the above-named taxpayer in the amounts of \$81,355.62 and \$52,091.49 for the years 1920 and 1921, respectively. The overassessments are covered by valid claims. The overassessment for 1920 is due to the allowance of special assessment under sections 327 and 328 of the revenue act of 1918. The overassessment for 1921 results chiefly from the allowance of an operating loss of the Tribune Co. of France, the elimination from income of alleged profit on sale of capital assets, increased invested capital and allowance of a credit for foreign taxes.

The Tribune Co. which had its inception in 1847 was incorporated in 1861 under the laws of the State of Illinois for the purpose of

publishing the Chicago Tribune. The taxpayer began with a capital stock of \$200,000. No change has been made in the original capital stock since the date of incorporation. Except for one qualifying share to each director The Tribune Co. (parent) owns the entire outstanding capital stock of the News Syndicate Co. of New York City and the Tribune Building Corporation of Chicago, Ill. These companies have been ruled affiliated with the Tribune Co. in accordance with the provisions of section 240 of the revenue acts of 1918 and 1921. In addition to the foregoing, the taxpayer owns the entire capital stock of the Ontario Paper Co. (Ltd.), of Thorold, Ontario, a foreign subsidiary corporation of Canada, from which it receives taxable dividends.

Under date of December 1, 1922, prior to final determination of taxable net income and statutory invested capital for 1920, the taxpayer made formal application for special assessment under the provisions of sections 327 and 328 of the revenue act of 1918 claiming that its invested capital, computed under the provisions of section 326 of the revenue act of 1918 is abnormally low; that its invested capital could not be satisfactorily determined and that the intangible values of circulation structure, advertising structure, news publication structure, and morgue and copyrights are not reflected in the statutory invested capital as allowed by the bureau. The application for special relief was not considered by the Income Tax Unit up to the time a 60-day letter was issued notifying the taxpayer of additional tax, this for the reason that the statute of limitation within which to assess taxes was about to expire. The taxpayer protested against the proposed deficiency for 1920, and filed an appeal with the United States Board of Tax Appeals in January, 1927.

In a brief dated January 12, 1927, various schedules were submitted by the taxpayer in support of its claim for special assessment. In order to show that circulation structure had been understated, the taxpayer endeavored to segregate expenditures from 1899 to 1918 under the following classifications: Publications, billboards, fences, circulars and letters, canvassers' salaries, premiums, traveling expenses, and premium purchase and expense, which were all indicated as expended for development and increasing the circulation structure of the Tribune. The claimed aggregate amount expended for this purpose for 1899 to 1917, inclusive, is \$2,441,998.27.

At a conference held on February 9, 1927, the Income Tax Unit conceded the abnormality in respect to the uncapitalized circulation values, contingent on proof by the taxpayer that the expenditures made in prior years were incurred in procuring new circulation. In a supplementary brief dated February 26, 1927, the taxpayer sets forth in detail the nature of expenditures over a period from 1890 to 1918 for advertising campaigns and prize contests carried on for the purpose of increasing the circulation. This office is persuaded that the taxpayer has shown that it built up a circulation structure of substantial value which did not enter as an element of statutory invested capital.

L. O. 1109 (C. B. 1-2, p. 253), which concerns itself in part with what classes of cases fall within the purview of section 327 (d) of the revenue act of 1918, states that among the typical and common cases in which there is present an abnormal condition affecting capital are those "where there are excluded from invested capital computed

under section 326 intangible assets, of recognized value and substantial in amount, built up or developed by the taxpayer." The present case qualifies as such a case.

On October 5, 1927, a conference was granted at the request of the taxpayer solely to permit the taxpayer to submit its proposal for settlement without the necessity of prosecuting the appeal. The special advisory committee reviewed the briefs and data filed by the taxpayer and concluded that there was an abnormality in this case which entitled the taxpayer to special assessment and so recommended in a memorandum approved December 5, 1927. Subsequently, the taxpayer and the Government filed a written stipulation with the United States Board of Tax Appeals as to the tax liability of the petitioner for the year 1920. On January 10, 1928, the board approved the stipulation entered into and found there was an overpayment of tax for the year 1920 in the amount of \$81,355.62. The consolidated net income of the taxpayer for the year 1920 as stipulated to for the purpose of special assessment is \$3,542,954.92, which is an increase of \$58,415.84 over the consolidated net income as reported on the taxpayer's original return.

The concerns selected as comparatives are engaged in the newspaper business and considering the various other essentials mentioned in the act, such as invested capital employed, volume of business, and net income, it is believed that the comparatives are representative and similarly circumstanced as nearly as may be with respect to all essentials.

The profits tax computed on the basis of statutory capital was \$989,288.52, and the percentage of profits tax to net income was 27.92 per cent. The profits tax computed under the provisions of section 328 based upon the stipulated consolidated net income is \$882,166.77, or the equivalent of 24.90 per cent on the taxable net income.

The taxpayer filed a consolidated income and profits tax return for the year 1921, reporting net income of \$2,155,464.69 and consolidated invested capital of \$9,245,043.49 upon which a tax was assessed of \$525,023.57. The consolidated net income as finally adjusted in the present audit is \$2,133,169.67 or a decrease of \$22,295.02. The consolidated invested capital as finally adjusted is \$9,522,802.50 or an increase of \$277,759.01. The net income of the Tribune Building Corporation (subsidiary) was not changed, while the net loss reported by the News Syndicate Co. (subsidiary) was reduced by \$9,305, representing bad debts and donations disallowed.

The additions to income of the Tribune Co. amount to \$112,190.53 and the decreases amount to \$143,790.55. The reduction in income is due to readjustment of alleged profit from the sale of capital assets originally returned in the amount of \$51,149.44, and the allowance of additional operating expenses connected with the publishing of the Paris edition of the Chicago Tribune in the amount of \$92,641.11.

The item representing alleged profit from sale of capital assets was erroneously entered on the tax return as income. This item could not be found on the books but was entered on the return only. No one knew from where the figures were obtained by the one who prepared the 1921 return. Since the source of this item is unknown and is not reflected on the books the same has been eliminated.

In the spring of 1917 the taxpayer conceived the idea of establishing or creating a Paris edition of the Chicago Tribune for the benefit of

Americans then in France. In December, 1920, the taxpayer incorporated its Paris branch under the laws of France and called the same the "Tribune Co. of France." The capital of said company was 100,000 francs, all of which capital was paid in by the taxpayer. The French company was in form a separate and distinct corporation although its actual relationship with the Tribune Co. was still that of a branch the same as before incorporation. The Tribune Co. continued to furnish its features, news, and other make-up at a nominal cost of materials just as it did before incorporation. The accounting remained the same. Representatives of the French company were former employees of the Chicago company assigned to the Paris office and the Chicago company considered itself responsible for all obligations of the French company. No additional functions were performed by the French company that were not performed by the branch organization. From incorporation in December, 1920, during and throughout 1921, there was a verbal agreement between the two companies whereby the Chicago company would advance (and in fact did advance) any and all funds needed by the French company for its operations, and would pay any annual net operating loss incurred in publishing and circulating the Paris edition of the Chicago Tribune. The branch while in existence in 1920, before incorporation, incurred an operating loss of approximately \$60,000 and conditions indicated that the operating loss for 1921 would even be larger.

On March 28, 1922, the verbal agreement theretofore existing was reduced to writing in an agreement bearing that date. The contract recites that since January 1, 1921, the French company has been carrying on this work for the Chicago company at the Chicago company's expense, that heretofore no written memorandum of these respective rights and obligations had existed between the parties and they are now desirous of reducing their understanding to writing as thereafter stated and after stating the purpose and consideration for the premises, mutual promises of the parties thereto, and other good and valuable consideration acknowledged and confessed, it was agreed "in consideration of the satisfactory performance by the publisher of the covenants herein imposed upon it by the Chicago company, the company shall pay the publisher annually in such installments as required an amount equivalent to the publisher's annual net operating loss incurred in publishing and circulating said edition and indemnify the publisher against said loss and other damage. 'Net operating loss' is defined as the excess of operating expense (including every kind of expense) over gross operating receipts. Net profits, if any, shall be divided 25 per cent to the company and 75 per cent to the publisher."

During the year 1921 the Tribune Co. of France sustained a net operating loss of \$218,426.01. The taxpayer only deducted on its original return \$125,784.90 representing the then determined operating loss of the Tribune Co. of France. This amount was disallowed by a revenue agent on the ground that the expenditure did not constitute an ordinary and necessary expense. The taxpayer protested and filed briefs in support of the deduction. From the evidence now on file the bureau has allowed the operating loss of the French company as a deduction under the provisions of section 234 (a) (1) of the revenue act of 1921 on the theory that there was a contract existing between the two companies and that payments made

pursuant to the contract constitute a deductible expense of the domestic corporation in determining its taxable net income. (See A. R. R. 723 C. B. 1-1, p. 113.) Instead of the loss being \$125,784.90, as originally reported by the taxpayer, a supplemental revenue agent's report dated March 30, 1926, discloses the correct operating loss to be \$218,426.01. The taxpayer's income has therefore been further reduced by the amount of \$92,641.11, the difference between the loss taken on the original return and the loss as finally determined.

As stated above, the taxpayer's consolidated invested capital originally reported is increased \$277,759.01. The additions to invested capital amounting in the aggregate to \$340,227.49 are composed of the following items: Additions to taxable income for years prior to 1921 on account of profits made by taxpayer's Paris branch (not originally reported by taxpayer but now included in income;) disallowance of losses claimed by taxpayer in adjusting prior years' tax liability, less the operating loss of the Paris branch in 1920, making a net restoration to invested capital of \$157,106.58 as of January 1, 1921; special assessment taxes amounting in the aggregate to \$17,038.17 paid on real estate (claimed as a deduction from gross income by taxpayer) but now considered capital charges and not deductible expenses; restorations made to plant and equipment account by reason of items arbitrarily written off, \$21,235.78; loss of \$84,705.60 alleged to have made been on sale in 1919 of steamers *Boyce* and *Linden* to the Ontario Paper Co. (Canadian subsidiary) disallowed as a deduction from income in 1919 and now restored to invested capital; adjustment of depreciation reserve, \$23,762.28; organization expenses arbitrarily written off in prior years and now restored to invested capital \$1,998.19; and adjusted proration of original 1920 income tax, \$34,380.89. The deductions to invested capital are composed of an adjustment of income taxes for 1918 and 1919 and prior year losses, amounting in the aggregate to \$62,468.48, thereby resulting in a net increase in invested capital of \$277,759.01.

The reduction of taxes for 1921 due to income and invested capital adjustments amounts to \$24,254.77. In addition to this the taxpayer has been allowed a credit for foreign taxes in the amount of \$27,836.72 for the year 1921, making a total overassessment of \$52,091.49.

As stated above the taxpayer owned the entire capital stock of the Ontario Paper Co. (Ltd.) for the years 1920 and 1921. On January 22 and July 5, 1921, the taxpayer received the sums of \$72,289 and \$101,627 as dividends upon the stock owned. Under the provisions of section 238 (e) of the revenue act of 1921 the first payment of dividends received in 1921 is deemed to have been made from 1920 profits and the second payment from 1921 profits. From the evidence on file and tax receipts submitted the taxes for 1920 were paid in 1921. Under section 240 (c) of the revenue act of 1918 credit for foreign taxes is limited to the amount of such taxes actually paid during the year. Since no tax was paid during the year 1920 no allowance for credit for foreign taxes has been allowed for the year 1920. The taxpayer has, however, been allowed a credit in 1921 for 1920 taxes paid in 1921. The profits for 1920 subject to taxes were \$879,676.86 and the taxes accrued thereon as paid were \$158,667.10, leaving net profits from which dividends were paid of \$721,009.75. In accordance with the provisions of section 238 (e) of the revenue act of 1921, the taxpayer is entitled to a credit for foreign taxes based

on the amount of such foreign taxes paid or accrued during the year on profits from which the dividends were paid in the proportion which the dividends received bear to the total profits from which paid. The percentage of dividends to net profits for 1920 is 10.03 per cent or \$15,914.31.

The profits for 1921 subject to taxes are \$2,099,607.88 and the taxes accrued thereon as paid are \$220,458.72, leaving net profits from which dividends were paid of \$1,879,149.06. The percentage of dividends to net profits for 1921 is 5.408 per cent or \$11,922.41. Inasmuch as the taxes for 1920 were paid in 1921 and no credit was allowed in 1920 the credit has now been allowed for the year 1921, making a total credit for foreign taxes for this year of \$27,836.72.

The credits allowed in each instance do not exceed that proportion of the taxes due the United States which the amount of the dividends received bears to the total amount of the net income of the taxpayer.

In view of the foregoing, it is recommended that the overassessments above indicated be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: June 4, 1928.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 9

JULY 19, 1928.

Mr. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury,
Washington, D. C.

DEAR MR. ALVORD: Inclosed herewith copy of a report by Mr. Chesteen, corporation auditor of this committee, in regard to the refund proposed in the case of The Tribune Co., Chicago, Ill. This refund was reported to the joint committee on June 21, 1928.

You will note that Mr. Chesteen does not concur in the final decision in this case.

Inasmuch as the date of payment of this refund is on July 21, the writer would suggest that the attorney in the general counsel's office who rendered the decision be asked to consider Mr. Chesteen's comments. As this attorney will be thoroughly familiar with the case, he will doubtless be able to decide at once whether this allowance should be reconsidered or not. This procedure will prevent any loss of interest to the Government.

Very truly yours,

L. H. PARKER.

IN RE THE TRIBUNE CO., CHICAGO, ILL.

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
July 17, 1928.

Mr. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above-named taxpayer in the amounts shown below:

1920-----	\$81,355.62
1921-----	52,091.49

FACTS

The refund for the year 1920 is due, in a large measure, to the allowance of special assessment as provided in sections 327 and 328 of the revenue act of 1918. Claim for special assessment is based upon the contention that the intangible values not reflected in the statutory capital resulted from the expenditures, in years prior to the excess profits tax, for circulation structure, advertising structure, news publication structure, and morgue and copyrights. The unit, after data had been submitted to the bureau, conceded the abnormality on these grounds. The evidence submitted tends to establish that an abnormality existed as defined by Law Opinion 1109. C. B. I-2, p. 253.) The comparatives used are newspapers, as follows:

The Evening Star, Washington, D. C.
A. S. Abell Co., Baltimore, Md.
Star Publishing Co., Indianapolis, Ind.
New York Times, New York City.
Times-Mirror, Los Angeles, Calif.

A study of the data sheet indicates that these companies are fairly representative companies, the average for these being 24.90 per cent tax, whereas by using the statutory capital, the taxpayer would have been assessed a rate of 27.92 per cent.

The overassessment for the year 1921 is due to the allowance of an operating loss of the foreign subsidiary company, known as the Tribune Co. of Paris, France. The facts with respect to this deduction are somewhat as follows: The Tribune Co. of Chicago, early in 1917, considered the publication of a newspaper in Paris, France. The circulation of this newspaper was, in a large measure, among the soldiers of the A. E. F. The paper was at first operated as a branch of the Tribune Co. of Chicago during the years 1917, 1918, 1919, and until the latter part of 1920. It seems that the Tribune Co. of Chicago, acting upon legal advice, decided, in the latter part of 1920, to incorporate the foreign branch due to the fact that there was a possibility of the French Government seeking to tax the income of the Tribune Co. of Chicago because of its operation of a branch in France. This statement is alleged in the brief, although it is not clear to the writer whether there is any foundation at all for this statement. The record indicates that the Paris branch was incor-

porated with a capital stock of 100,000 francs, all of which was owned by the Tribune Co. of Chicago, all assets, it seems, and liabilities of the branch being transferred to the newly organized company for its capital stock.

The foreign subsidiary operated for the year 1921 at a loss of \$218,426.01. This figure, it appears, is a corrected figure that was determined long after the close of the taxable year 1921. For the year 1921, it appears, the Tribune Co. of Chicago deducted in its return, \$125,784.90. This amount was first disallowed by the agent on the grounds that it was not an ordinary and necessary expense of the Chicago company. Protest was made to this disallowance and after discussion with the bureau and a supplemental report, the loss was determined to have been the figure mentioned above. The taxpayer contended in conference that the loss was deductible and constituted an ordinary and necessary expense of the company. Mr. F. A. Linzel, conferee, technical staff, consolidated division, in recommending the allowance of this item, commented as follows:

OPERATING LOSS, TRIBUNE CO. OF FRANCE, \$125,784.90, YEAR 1921

In December, 1920, the taxpayer incorporated its Paris branch under the laws of France and called the same "The Tribune Co. of France"; capital of said company being 100,000 francs, all of which capital was paid in by the taxpayer. It is stated that the purpose of incorporating the branch under the laws of France was to escape the possibility of the taxpayer company being subjected to French income tax on its entire income from American as well as French sources if the Paris edition of the Chicago Tribune was continued merely as a branch.

The history of the Paris edition of the Chicago Tribune is fully set forth in briefs heretofore filed by the taxpayer. While in form the French corporation was a separate and distinct corporation, its actual relationship with the Tribune Co. was still that of a branch, the same as before. No change in policy, purpose or management resulted from the incorporation. The Tribune Co. continued to furnish its features, news, and other make-up at a nominal cost of materials just as it did before incorporation. The accounting remained the same; representatives of the French company were only employees of the Chicago company assigned to the Paris office and the Chicago company considered itself responsible for all obligations of the French company. No additional functions were performed by the French corporation that were not performed by the predecessor organization. From incorporation in December, 1920, during and throughout 1921, there was a verbal agreement between the two companies that the Chicago company would advance any and all funds needed by the French company for its operations and would pay any annual net operating loss incurred in publishing and circulating the Paris edition of the Chicago Tribune. The branch while in existence in 1920 before incorporation incurred an operating loss of approximately \$60,000 and conditions indicated that the operating loss for 1921 would be even larger.

On March 28, 1922, the verbal agreement theretofore existing was reduced to writing in an agreement bearing that date. The contract recites that since January 1, 1921, the French company has been carrying on this work for the Chicago Company, at the Chicago company's expense; that heretofore no written memorandum of their respective rights and obligations had existed between the parties and they are now desirous of reducing their understanding to writing as therein-after stated; and after stating the purpose and consideration for the premises, mutual promises of the parties thereto and other good and valuable consideration acknowledged and confessed, it was agreed "in consideration of the satisfactory performance by the publisher of the covenants herein imposed upon it by the Chicago company, the company shall pay the publisher annually in such installments as required an amount equivalent to the publisher's annual net operating loss incurred in publishing and circulating said edition and indemnify the publisher against said loss and other damage. 'Net operating loss' is defined as the excess of operating expense (including every kind of expense) over gross operating receipts. Net profits, if any, shall be divided 25 per cent to the company and 75 per cent to the publisher."

It is stated that the effect of this contract was an engagement by the Tribune Co. of the French company as agent of an edition of the Chicago Tribune and had the contract stipulated a monthly or annual specific sum for these services there could be no doubt about its deductibility as an operating expense.

It is also submitted that the intent of the parties in making the contract retroactive to January 1, 1921, and confining the verbal agreement in existence between January 1, 1921, and March 23, 1922, establish that a contract was in existence during the year 1921 and the money paid to cover the operating loss of the French company, in amount, \$125,784.90, which amount constitutes an ordinary and necessary business expense, and is deductible as such by the taxpayer for 1921.

The agent disallowed the deduction for the year 1921 on the ground that the agreement of March 23, 1922, was without retroactive effect and for the further reason that a corporation was not entitled to deduct sums paid to cover another corporation's obligations unless the corporations were consolidated.

The taxpayer submits that the verbal contract in force, later confirmed by a written agreement, had full force in effect and is binding.

With respect to the argument that one corporation can not deduct the operating loss of another unless they are allowed to file consolidated returns, it is submitted that the separate legal entity theory of corporations is involved and that this theory destroys the logic of the contention, holding that unless separate corporate entities theory be recognized a parent company could not legally contract with its subsidiary.

The taxpayer further cites A. R. R. 723, where the department has held that a domestic corporation may legally contract with a foreign corporation even though one of the corporations owns all of the stock of the other and that payments made pursuant to the contract constitute a deductible expense of the domestic corporation in determining its taxable net income.

It is further urged by the taxpayer that even if the reasons advanced were not sufficient to allow the deduction that the accounts of the taxpayer corporation and the Tribune Co. of France should be consolidated under section 240 (d) of the 1921 act.

DECISION

On the face of the arguments submitted and the citations given, it is believed that the Chicago Tribune was party to a legally enforceable contract with the French company and was liable for expenses incurred in the operation and publishing of the Paris edition of the Chicago Tribune by the Tribune Co. of France. Further, that such expense incurred was an ordinary and necessary operating expense. The conclusion may be open to some criticism from the legal standpoint, but taken in consideration with section 240 (d) of 1921 act, article 637, Regulations 62, specifically, it is believed that sufficient authority exists for the allowance of the above amount.

The office of general counsel, in approving the overassessment for the year 1921, approved the action of the conferee with the following comments:

During the year 1921 the Tribune Co. of France sustained a net operating loss of \$218,426.01. The taxpayer only deducted on its original return \$125,784.90, representing the then determined operating loss of the Tribune Co. of France. This amount was disallowed by a revenue agent on the ground that the expenditure did not constitute an ordinary and necessary expense. The taxpayer protested and filed briefs in support of the deduction. From the evidence now on file the bureau has allowed the operating loss of the French company as a deduction under the provisions of section 234 (a) (1) of the Revenue Act of 1921 on the theory that there was a contract existing between the two companies and that payments made pursuant to the contract constitute a deductible expense of the domestic corporation in determining its taxable net income. (See A. R. R. 723, C. B. I-1, p. 113.) Instead of the loss being \$125,784.90 as originally reported by the taxpayer a supplemental revenue agent's report dated March 30, 1926, discloses the correct operating loss to be \$218,426.01. The taxpayer's income has therefore been further reduced by the amount of \$92,641.11, the difference between the loss taken on the original return and the loss as finally determined.

OPINION

The writer is unable to concur in the action of the conferee and the office of general counsel, and submits the following opinion in substantiation of his contention that no legal grounds exist for the proposed allowance of this item. Stripped of all technicalities, the facts are as follows:

The Tribune Co. of Chicago in 1920 incorporated its foreign publication which up to that time it had operated as a branch. The entire stock of the foreign subsidiary was issued to the parent company for the assets and liabilities of the branch. The foreign subsidiary had no plant and equipment, the paper being published under contract with some foreign person not disclosed in the briefs. Money and finances to operate the foreign branch were, so far as practical, employed from assets of the foreign branch. It is true that the management of the foreign branch was entirely under the domination of the taxpayer, just as any other subsidiary company would be where the parent owns all the stock of the subsidiary company. It appears that the employees of the Chicago Tribune were assigned to the subsidiary branch and their salaries were paid by the foreign subsidiary company. As a result of the operation of the foreign subsidiary, a loss in the amount of approximately \$200,000, as stated above, was sustained. The taxpayer, in 1922, drew up a contract between it and the subsidiary company which purports to be an oral contract previously entered into but now reduced to writing. This contract purports to show that the parent company agreed to reimburse the subsidiary company for any operating loss which it sustained.

Section 240 of the revenue act of 1921 specifically excluded foreign subsidiaries from being affiliated with domestic corporations which own all the stock of the foreign companies. This specific exclusion indicates that Congress did not intend that domestic corporations should be relieved of tax on account of losses incurred by foreign subsidiary companies. Subsection (d) of section 240 further provided:

* * * That in any case of two or more related trades or business (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the commissioner may consolidate the accounts of such related trades and businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses.

The Finance Committee of the Sixty-seventh Congress, in recommending the enactment of this provision, commented as follows:

A new subdivision is added to this section, giving the commissioner power to consolidate the accounts of related trades or businesses owned or controlled by the same interests, for the purpose only of making an accurate distribution of gains, profits, income, deductions, or capital among the related trades or businesses. This is necessary to prevent the arbitrary shifting of profits among related businesses, particularly in the case of subsidiary corporations organized as foreign trade corporations.

The above-quoted comments with respect to the enactment of section 240 (d) of the revenue act of 1921 indicate that Congress intended to give the commissioner full power to prevent the shifting of deductions or income from a domestic corporation to a foreign business which was controlled or owned by it. The contract purported to

have been entered into in this case in 1922 appears nothing more than an attempt on the part of the taxpayer to secure the benefit of the loss incurred by the foreign subsidiary in the computation of its tax, something which Congress specifically provided in the revenue act should not be allowed. The comments, therefore, of the conferee in quoting section 240 (d) as authority for the allowance of the item are not in accord with his own decision.

It is noted the taxpayer quoted A. R. R. 723 and the office of general counsel has relied upon this decision in approving the refund so proposed. It is submitted that A. R. R. 723 is not a parallel case to the question involved. In A. R. R. 723 two questions were involved: First, whether or not the old company, a domestic corporation, was entitled to a deduction for the year 1917 on account of an amount paid to A, an individual trading under the partnership name of B company, as a reimbursement of premiums paid by the B partnership to the M company, a foreign corporation, the M company being the owner of all the stock of the old company. This case was first given consideration by the bureau in A. R. M. 72, and a decision contrary to A. R. R. 723 was promulgated. The office of the solicitor reconsidered A. R. M. 72 and found the facts upon which the decision was based were erroneous, and therefore reversed the previous ruling. The reasons for the reversal were that in the first instance it was represented that A, the individual, was one of a number of heirs who owned the M company. In A. R. R. 723 it appears that this was not true and that A was one of a number of heirs who held only a nominal amount of the M company's stock. Under those circumstances it is apparent that the office of the solicitor was forced to recognize the separate corporate entities, and transactions entered into between these corporate entities were the basis of the final settlement.

These facts are entirely different from the facts in the instant case. In the case of the above-named taxpayer we have a parent company entering into a contract with the foreign subsidiary company in which it owns the entire capital stock. It may be said, therefore, to be dealing with itself in any contractual relationships. A. R. R. 723 was based upon the 1917 statute. This statute contained no provision for the consolidation of accounts as appears in section 240 (d) of the revenue act of 1921. It is therefore submitted that the legal grounds advanced by the office of general counsel for the allowance of the refund are not applicable to the revenue act of 1921, in that the citation referred to is based upon another statute other than the one under which the refund is proposed; and, secondly, that the facts in the case cited are entirely different from the facts in the instant case; thirdly, that the proposed allowance of the deduction seeks to permit the domestic corporation to absorb the loss of the foreign subsidiary, a principle which is specifically prohibited in the revenue act of 1921.

For your information there is attached a copy of the purported contract agreement entered into in 1922.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

EXHIBIT A

Memorandum of agreement, made and entered into, at Chicago, Ill., U. S. A., March 28, 1922, by and between The Tribune Co., a corporation of the State of Illinois, U. S. A. (hereinafter referred to as the company), and The Tribune Co. of France, a corporation of the Republic of France (hereinafter referred to as the publisher), witnesseth:

On or about January 1, 1918, while the Great War was in progress and a great many American citizens were located in France in the overseas fighting forces of the United States, the company began to publish and circulate in Paris and elsewhere in France an edition of the company's newspaper, The Chicago Tribune.

Said edition was published under the name The Chicago Tribune, carried substantially the same news and features, and, in all respects, including general appearance, was made as far as possible the facsimile of The Chicago Tribune. The company's purpose in this regard was to furnish the Americans abroad a home newspaper, which time and distance prohibited, and could only be supplied by republishing the newspaper abroad. By doing this the company sought to increase its circulation and prestige both at home and abroad, and at the same time internationalize its newspaper both as a news and advertising medium.

This work of publishing and circulating said European edition was for a while carried on by the company through its own foreign staff, always at a considerable loss, which the company has considered merely as a part of its general exploitation expense.

Since January 1, 1921, however, the publisher has been carrying on this work for the company at the company's expense. Heretofore no written memorandum of their respective rights and obligations has existed between the parties and they are now desirous of reducing their understanding to writing as hereinafter stated.

Now, therefore, in consideration of the premises, the mutual promises of the parties hereto, and other good and valuable considerations, receipt whereof is hereby acknowledged and the sufficiency whereof is hereby confessed, it is mutually agreed as follows:

First. During the life of this contract the publisher, subject to the company's supervision and control, shall publish daily in Paris, France, and circulate upon the continent of Europe, an edition of the Chicago Tribune which as near as possible will be a facsimile of said newspaper.

Second. The company shall, without charge, furnish the publisher with the contents and make-up of the edition in ample time for publication each day.

Third. In consideration of the satisfactory performance by the publisher of the covenants herein imposed upon it, the company shall pay the publisher annually in such installments as required, an amount equivalent to the publisher's annual net operating loss incurred in publishing and circulating said edition, and indemnify the publisher against said loss and other damage. "Net operating loss" is defined as the excess of operating expense (including every kind of expense) over gross operating receipts. Net profits, if any, shall be divided 25 per cent to the company and 75 per cent to the publisher.

Fourth. An annual accounting shall be had between the parties at the close of each calendar year. The publisher's books shall be subject to inspection and audit at any time by the company.

Fifth. The parties agree that the publisher is not engaged to publish and exploit an independent newspaper, but to publish an edition of the Chicago Tribune, which can not be published in Chicago on account of the intervening distance.

Sixth. Labor difficulties, embargoes, interruption of transportation or communication, and other causes beyond the control of either party, whether similar to the causes specified herein or not, shall excuse performance of this contract during the duration of such causes.

Seventh. This contract shall remain in full force and effect until terminated by 90 days' written notice of either party to the other of its desire to terminate the contract.

In witness whereof the parties have caused this contract to be executed by their duly authorized officers on the day and year first above mentioned.

THE TRIBUNE CO.,
By J. M. PATTERSON.
THE TRIBUNE CO.,
By ROBERT R. McCORMICK.

APPENDIX 9(A)

IN RE THE TRIBUNE CO., CHICAGO, ILL.

TREASURY DEPARTMENT,
Washington, June 11, 1929.Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.*

DEAR MR. PARKER: There is transmitted herewith a copy of a memorandum prepared by the office of the general counsel of internal revenue with reference to the overassessment proposed in favor of the above-named company.

It is believed that this consideration of the case meets the questions raised in the report of Mr. Chesteen.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

Mr. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury:

Reference is made to the attached memorandum dated July 19, 1928, from Mr. L. H. Parker, chief, division of investigation of the Joint Committee on Internal Revenue Taxation, relative to the above indicated case.

Pursuant to the provisions of section 710 of the revenue act of 1928 the case was submitted to the Joint Committee on Internal Revenue Taxation under date of June 21, 1928, in connection with overassessments of \$81,355.62 and \$52,091.45, for the years 1920 and 1921, respectively. Upon review of the case Mr. G. D. Chesteen, corporation auditor for the division of investigation, objected to the bureau's allowance of a certain deduction to the taxpayer amounting to \$218,426.01 for the year 1921, growing out of the following transaction:

During the year 1917 the Tribune Co. of Chicago began the publication of a Paris edition of its paper largely for the benefit of the American Expeditionary Forces. The Paris edition was published through a branch of the domestic company until December, 1920, when it was incorporated under the laws of France. It appears that the motive for incorporation was a threat on the part of the French Government to tax the income of the Chicago company because of its Paris branch. The Paris branch was incorporated with a capital stock of 100,000 francs which was issued to the Chicago company in exchange for the assets of its Paris branch.

There was no change in relationship between the Chicago company and the Paris branch as a result of incorporation. The Tribune Co. continued to furnish its features, news, and other make-up to the French company at the cost of material as it did before incorporation. The accounting remained the same and employees of the Chicago company were assigned to the Paris office.

From January 1 to December, 1920, the Paris branch had sustained a net loss of approximately \$60,000 and conditions indicated that the operating loss would continue in 1921. On March 28, 1922,

the Chicago company and the Paris company entered into a written contract, which according to its terms, was for the purpose of reducing the prior oral agreement of the companies to writing. The contract in substance provided that the Paris company, subject to the Chicago company's supervision and control, should publish daily in Paris, France, and circulate upon the continent of Europe, an edition of the Chicago Tribune which as near as possible should be a facsimile of said paper; that the Chicago company should continue without charge to furnish the Paris company with the contents and make-up of the edition in ample time for publication each day; that in consideration of the satisfactory performance of the covenants imposed, the domestic company should pay the Paris company an amount equivalent to the Paris company's annual net operating loss incurred in publishing and circulating said edition; that in the event profits were realized they should be divided 25 per cent to the Chicago company and 75 per cent to the Paris company and that the Paris company was not to publish and exploit an independent newspaper, but merely to publish an edition of the Chicago Tribune which could not be published in Chicago on account of the intervening distance.

Mr. Chesteen seems to take the view that since Congress, by section 240 (c) of the revenue act of 1921, specifically excluded a foreign subsidiary from being affiliated with a domestic parent company, it follows that Congress did not intend that a domestic company should be relieved of tax on account of the deduction of losses incurred by its foreign subsidiary. Furthermore, that the commissioner, through the provisions of subdivision (d), section 240, which relates to consolidation of accounts in proper cases of closely related businesses, has full power to prevent the shifting of deductions or income from a domestic to a foreign business.

The reason for nonaffiliation of a domestic and a foreign corporation is that Congress has no power to tax such foreign corporation or other foreign subject with certain exceptions not relevant here. The companies being legally independent entities, a domestic corporation is usually in a position to arrange its affairs with its foreign subsidiary by written contract, such as we have here, or otherwise, so as to avoid domestic tax so far as section 240(c), pertaining to consolidated returns, is concerned. Section 240(d) was enacted to prevent such arbitrary shifting of profits in certain cases. This section provides:

For the purposes of this section a corporation entitled to the benefits of section 262 shall be treated as a foreign corporation: *Provided*, That in any case of two or more related trades or businesses (whether unincorporated or incorporated and whether organized in the United States or not) owned or controlled directly or indirectly by the same interests, the commissioner may consolidate the accounts of such related trades and businesses, in any proper case, for the purpose of making an accurate distribution or apportionment of gains, profits, income, deductions, or capital between or among such related trades or businesses.

In explaining this new provision, the House Committee on Ways and Means said:

Subsidiary corporations, particularly foreign subsidiaries, are sometimes employed to "milk" the parent corporation, or otherwise improperly manipulate the financial accounts of the parent company. To prevent this abuse, section 240 would give the Commissioner of Internal Revenue power to consolidate the accounts of two or more related trades or businesses solely for the purpose of making an accurate distribution of gains, profits, income, deductions, or capital and not for the purpose of computing the tax on the basis of the consolidated return. (H. Rept. No. 350, 67th Cong., 1st sess., p. 14.)

The Senate Committee on Finance said:

A new subdivision is added to this section giving the commissioner power to consolidate the accounts of related trades or businesses owned or controlled by the same interests, for the purpose only of making a correct distribution of gains, profits, income, deductions or capital, among the related trades or businesses. This is necessary to prevent the arbitrary shifting of profits among related businesses, particularly in the case of subsidiary corporations organized as foreign trade corporations. (S. Rept. No. 275, 67th Cong., 1st sess., p. 20.)

Section 240(d) thus placed in the commissioner a power which in his discretion he could exercise in a proper case. The comments of the House Ways and Means Committee and the Senate Finance Committee, as well as the language of the act itself, indicates that it was contemplated that the commissioner should ordinarily exercise his power where the foreign subsidiary was employed to milk the domestic company or otherwise manipulate the financial accounts of the domestic company. If this condition is found to exist, the commissioner may consolidate the accounts of the domestic and foreign companies for the purpose of making an accurate distribution of the gains, profits, income, deductions or capital between or among such related trades or businesses.

In the present case we find the domestic company entering a foreign field at a time when many American citizens were located in the overseas fighting forces of the United States and in doing so seeking to increase its circulation and prestige both at home and abroad by internationalizing its paper as a news and advertising medium. Losses were incurred as they often are during the pioneering stage of an enterprise. The taxpayer seems to have been in much the same position as another domestic corporation which, say, establishes an advertising agency in a foreign country so that the people of that country may be properly advised of the qualities of its products, or in much the same position as another domestic taxpayer which spends substantial sums in reclaiming South American lands prior to colonization of such lands. Section 240(d) was obviously not intended to deny domestic corporations such expenses as these in computing taxable income provided the accounts between the domestic company and the foreign enterprise do not show an artificial shifting of profits, deductions, etc.

In the present case there seems to be no question but that the accounts between the two companies were regular and proper except that the domestic company furnished the Paris company with the contents and make-up of the Paris edition at cost to the domestic company, the effect of which was to decrease the loss of the Paris company. If more had been charged and the accounts of the companies consolidated under section 240(d), the profit resulting to the domestic company on this account would merely have offset the additional loss of the foreign company. On the other hand, if the Paris company had been making a profit, a consolidation of accounts under section 240(d) would result in a greater profit to the domestic company and a less profit to the foreign company. Where the commissioner invokes section 240(d) his powers as to avoidance of domestic tax are limited to the particular accounts between the related trades or businesses. He can not, for example, tax a domestic corporation on the undistributed earnings of a foreign subsidiary where such earnings are not attributable to the accounts between the domestic and the foreign company. He has no power, as

Mr. Chesteen seems to intimate, to deny a domestic company a deduction of an operating loss of a foreign subsidiary where under an agreement based on good consideration the domestic company agrees to pay such loss and where the loss is not attributable to the accounts between the companies.

Upon consideration of the facts in the light of Mr. Chesteen's comments, it is my opinion that section 240(d) is not applicable to the case.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

APPENDIX 9(B)

JUNE 15, 1929.

In re the Tribune Co., Chicago, Ill.

Mr. L. H. PARKER,

*Chief, Division of Investigation,
 Joint Committee on Internal Revenue Taxation,
 House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Reference is made to Appendix 9(A) of the report of the Joint Committee on Internal Revenue Taxation on refunds for the calendar year 1928. The above reference contains a memorandum of Mr. E. C. Alvord, special assistant to the Secretary of the Treasury, embodying an opinion of Mr. C. M. Charest, general counsel, Bureau of Internal Revenue, under date of July 19, 1928, dealing with refunds proposed to the Chicago Tribune, Chicago, Ill., for the years 1920 and 1921, in the amounts of \$81,355.62 and \$52,091.49, respectively. It seems to me that all the facts, as well as the position of the joint committee, have not been fully set forth, and, for that reason, I am constrained to offer certain criticisms to the memorandum above mentioned.

The above memorandum of the office of general counsel deals especially with the proposal of the bureau to allow a deduction to the Chicago Tribune Co. of Illinois in the amount of \$218,426 for the year 1921, which, in fact, represents an operating loss to a 100 per cent owned foreign subsidiary located in Paris, France. The commissioner, under date of May 28, 1928, certified the above refunds to the Joint Committee on Internal Revenue Taxation giving his grounds for the allowance of the deduction above questioned as follows:

From the evidence now on file, the bureau has allowed the operating loss of the French company as a deduction under the provisions of section 234 (a) (1) of the revenue act of 1921 on the theory that there was a contract existing between the two companies, and that payments made pursuant to the contract constituted a deductible expense of the domestic corporation in determining its taxable income. (See A. R. R. 723, C. B. I-1, p. 113.)

It is obvious from the above-quoted memorandum that the opinion relied upon by the commissioner in the allowance of the item in question was A. R. R. 723. In my memorandum of review, dated July 19, 1928, I analyzed the facts upon which A. R. R. 723 was based and showed that this decision was reversed by A. R. M. 72, for the reason that all the facts were not before the bureau at the time of the former decision. To this criticism the office of general counsel makes no reply.

The only other grounds cited by the commissioner for the allowance of the item in question is section 234 (a) (1) of the revenue act of 1921. The pertinent part of this provision reads as follows:

That in computing net income there shall be allowed as a deduction: (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

The bureau in citing the above-quoted authority relies on the fact that a contract for a valuable consideration was entered into between the parties on March 22, 1922, purporting to reduce to writing an oral agreement claimed to have existed for 1921. The terms of the contract give to the parent company nothing which it as owner of the entire stock of the subsidiary could not have obtained by the mere declaration of a dividend. The fact that the parent company continued the same relations with the foreign subsidiary during 1921 as it had maintained toward its branch office prior to the incorporation of the foreign subsidiary does not constitute sufficient evidence that a contract existed between the parent and subsidiary during the calendar year 1921.

The effect of the bureau ruling is to permit the consolidation of a domestic corporation with its foreign subsidiary, a principle which Congress intended should not be permitted.

There is ample legal precedence for the position that the bureau, in view of the facts in this case, should have held: (1) That looking through the form of the contract, the purpose of the whole transaction was tax avoidance; (2) that if the contract was valid it had no retroactive effect.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 10

IN RE ALUMINUM CO. OF AMERICA, PARENT, AND SUBSIDIARIES, PITTSBURGH, PA.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
June 4, 1928.

Mr. COMMISSIONER: Certificates of overassessment have been prepared as follows:

Aluminum Cooking Utensil Co. (1917).....	\$8. 50
Aluminum Ore Co. (1917).....	171. 01
American Bauxite Co. (1917).....	1, 068. 16
Electric Carbon Co. (1917).....	13. 88
St. Lawrence River Power Co. (1917).....	449. 21
Aluminum Co. of America (1917).....	1, 285, 715. 88
Total.....	1, 287, 426. 64

For the year 1917 the Aluminum Co. of America filed returns of income on Forms 1031 and 1103, reflecting a net income of \$17,-

243,499.37. At the same time there was filed a consolidated excess profits tax return, Form 1103, showing a net income of \$28,532,385.39, inclusive of \$1,155,250 in dividends. The consolidated invested capital was \$64,051,029.46, and by the use of pre-war data, the rate of deduction was fixed at the maximum of 9 per cent. The consolidated excess-profits tax was computed at \$8,739,557.68, of which \$5,495,026.28 was allocated to the parent, so that the total tax of the latter amounted to \$6,153,724.66, which was assessed.

The consolidated excess-profits tax return included with the parent, pursuant to T. D. 2662, the following (all domestic) subsidiaries, and the portions of the excess-profits tax of \$8,739,557.68 allocated to each were as follows:

Aluminum Co. of South America	\$2, 405. 43
Aluminum Cooking Utensil Co.....	91, 943. 97
Aluminum Ore Co.....	536, 295. 96
Aluminum Seal Co.....	22, 208. 85
American Bauxite Co.....	383, 477. 39
Knoxville Power Co	
Pittsburgh Reduction Co.....	
Electric Carbon Co.....	74, 533. 40
Republic Mining & Manufacturing Co.....	23, 377. 22
St. Lawrence Gas, Electric & Transportation Co.....	
United States Aluminum Co.....	2, 031, 170. 29
Tallassee Power Co.....	
St. Lawrence Securities Co., parent of Long Sault Development Co., Pine Grove Realty Co., St. Lawrence River Power Co., parent of Hannawa Falls Water Power Co. and St. Lawrence Transmission Co.....	79, 118. 89

The various subsidiaries filed separate returns for 1917, and those having income were separately assessed.

The bureau made an audit of the various returns for 1917, in which numerous changes were made in the net incomes returned, as well as in the consolidated invested capital. There were included in the consolidation the following additional corporations:

Alton & Southern Railroad Co.
 Bauxite & Northern Railway Co.
 Pierson, Roeding Co.
 Massena Terminal Railroad Co.
 St. Lawrence Water Co.
 Massena Electric Light & Power Co.
 Northern Power Co.
 Potsdam Electric Light & Power Co.
 Ogdensburg Power & Light Co.
 Ogdensburg Gas Co.
 Ogdensburg Street Railway Co.

The results of this audit were set forth in a letter to the parent corporation, dated February 12, 1923, wherein the consolidated net income, exclusive of dividends, was \$27,332,240.84, the consolidated invested capital \$59,415,003.57, and the total excess profits tax \$9,268,944.06. This was allocated to 16 of the corporations in the group so that the entire additional amount would fall upon the parent, except that arbitrary amounts were applied in some cases

to avoid certificates of overassessment. The changes in tax liability were shown as follows:

	Additional tax	Over- assessed
Parent company.....	\$498,514.42	
Alton & Southern Railroad Co.....		\$8,288.57
Aluminum Cooking Utensil Co.....	3,413.46	
Aluminum Co. of South America.....	128.90	
Aluminum Ore Co.....	6,155.37	
Electric Carbon Co.....	749.93	
Republic Mining & Manufacturing Co.....	138.67	
St. Lawrence Water Co.....	70.32	
Massena Electric Light & Power Co.....	72.00	
St. Lawrence River Power Co.....	430.03	
St. Lawrence Transmission Co.....	144.49	
Ogdensburg Gas Co.....	72.01	
Ogdensburg Power & Light Co.....	154.61	
Tallassee Power Co.....		895.92
Pine Grove Realty Co.....		1,056.60

The several additional taxes were assessed in March, 1923, and the three overassessments were formally allowed to the respective corporations. On March 13, 1923, a brief was filed by the taxpayer, and on May 24, 1923, June 16, 1923, July 13, 1923, December 3, 1923, and later, additional briefs were filed, raising numerous objections to the adjustments made in the audit letter of February 12, 1923, which had also included the audit results for 1918 and 1919. The audit of these two years, however, has not yet been revised and is not involved herein. In waivers executed March 9, 1928, by the parent company and various subsidiaries it is agreed that any taxes determined upon the basis of a consolidated return of the parent company and subsidiaries shall be allocated to and assessed against the Aluminum Co. of America.

The present reductions in tax liability proposed in the certificates of overassessment will be explained. The major item affecting consolidated net income is the treatment of intercompany profits in opening inventories.

In the case of the parent company, the net income of \$17,243,499.37 has been increased to \$17,285,435.48, although the figure used in the February 12, 1923, letter was \$17,407,712.77. The increase in net income in the prior audit resulted from the disallowance of sundry donations deducted in the return, of expenditures for acquisition of capital assets, and of a loss claimed on liquidation of the Long Sault Development Co. The last item, consisting of \$146,254.13, was only transferred to the St. Lawrence Securities Co. There was an offsetting adjustment of \$56,832.68, representing revision of inventories resulting from changes in the overhead charges. In the present audit there are a few minor reductions to net income but the chief item, aside from the intercompany profits in opening inventories, is a loss of \$116,554.21. The facts with reference to this item are briefly as follows:

In the latter part of 1914 certain shipments were made of aluminum ingots to consignees in Norway and Sweden, but they were seized on the high seas, condemned as contraband, and taken to an English port by the British Navy. These shipments were made through a broker with whom the taxpayer had been previously dealing, operating under the name of L. Vogelstein & Co. The corporation did not

relinquish its claim to reimbursement for the aluminum so seized, but prosecuted same before the British prize court, although proceeding in the name of the broker, to whom an assignment was made in 1916. Among the reasons for not prosecuting its claim in the British prize court, it has been suggested that loss of the action might have prejudiced the interests of a Canadian (unaffiliated) subsidiary. The British prize court decision was rendered January 11, 1917, and sustained the seizure as lawful prize. The amount of this loss, including an adjustment made with the broker, has been computed as \$116,554.21, and allowed as a deduction for 1917. The sales of this aluminum were taken up in income for 1914. The loss is allowed for 1917 as a closed transaction in that year. (18 American Journal of International Law, 483, 494, and authorities therein cited.) The case is distinguished from that of *United States v. S. S. White Dental Manufacturing Co. of Pennsylvania* (274 U. S. 398, T. D. 4059), since the seizure was not made by an enemy country, and resulted in a claim that could be prosecuted immediately.

The 1917 return filed by the Aluminum Cooking Utensil Co. showed a net income of \$312,460.53, and a tax liability of \$105,174.96, which was assessed. The additional assessment of \$3,413.46 in March, 1923, is above noted. In the present audit the net income is increased to \$369,209.84 chiefly due to reduction of opening inventories, on account of a 10 per cent inflation thereof, but the certificate of overassessment results directly from the allowance of additional depreciation of \$141.67, on construction equipment, and on furniture and fixtures, formerly charged to expense in error.

The Aluminum Ore Co.'s return for 1917 reflected a net income of \$2,302,588.95, and a tax liability of \$642,273.54, which was assessed. The additional assessment of \$6,155.37 has already been mentioned. The revised net income is now \$2,402,328.30, the increase being due to disallowance as expense deductions of sundry capital expenditures, contingent reserves, and minor items, offset by closing inventory reduction and other minor items. The present reduction to the net income formerly adopted is attributable to allowance of additional depreciation of \$2,850.08 on assets previously charged to expense.

The American Bauxite Co. filed its return for 1917, showing a net income of \$1,346,736.93, and a tax of \$441,272.96, which was assessed. The present audit indicates a revised net income of \$1,320,196.40. While certain increases to income are found proper, for capital assets charged to expense and contingent reserve increases disallowed as deductions, the reductions are due to allowance of stripping costs, additional depletion of \$1,286.60, inventory revisions, and a few minor items.

With reference to the Electric Carbon Co., its return for 1917 showed a net income of \$311,412.72, upon which an assessment was made of \$88,746.16, the amount of tax liability therein indicated. The additional assessment of \$749.93, made in March, 1923, has already been noted above. The present net income is \$323,680.18. The increase in net income is due to excessive charges for accidents and to improper charges to expense for capital acquisitions, offset in part by reductions for excessive discounts received and inventory changes. The certificate of overassessment results from the allowance of \$231.38 additional depreciation on construction equipment now restored to the asset account, over the amount allowed in March, 1923.

The 1917 return by the St. Lawrence River Power Co. showed a net income of \$1,068,905.16, and the tax liability of \$138,506.06 shown on said return was assessed. The additional assessment of \$430.03, in March, 1923, has been mentioned above. The present net income is \$1,068,585.35. The February, 1923, audit letter increased the net income returned, on account of disallowance of a credit to a contingent reserve and of a loss recorded in 1917 on a sale of land in 1916, and there were a few other minor changes. The net income thus determined in 1923 has now been reduced by the credit to the contingent reserve, since it was not charged against 1917 profits, and by the loss item, because the loss was not charged to profit and loss in 1917. The two items amount to \$7,486.81, and produce the over-assessment certificate.

In considering the consolidated invested capital, it may be stated that the affiliations are class A in character, that is, the parent corporation owned all or substantially all of the stock of various subsidiaries, one of which (the St. Lawrence Securities Co.) was parent of three subsidiaries, and one of these (the St. Lawrence River Power Co.) was parent of two subsidiaries. Subsequent to 1917 there were a number of changes in the affiliated corporations, so that not all are still in existence, but such changes do not affect the 1917 tax liabilities. There are a number of other subsidiaries, whose stock ownership was sufficient to justify their inclusion in the present consolidation, but whose business has not been regarded as the same as, or closely related to, that of the other corporations included in the consolidation. Other foreign subsidiaries have not been included in the consolidation because not permitted by section 1331 of the revenue act of 1921. The domestic subsidiaries excluded from consolidation, none of which had large incomes in 1917, were the Alton & Southern Railroad Co., Massena Electric Light & Power Co., Ogdensburg Gas Co., Ogdensburg Power & Light Co., Ogdensburg Street Railway Co., Potsdam Electric Light & Power Co., and St. Lawrence Water Co. Two railroads have been retained in the group, namely, the Bauxite & Northern Railway Co. and the Massena Terminal Railroad Co., although they are public utilities, because they serve other corporations properly included in the consolidation as plant facilities. The former railroad connects the Arkansas plants of the American Bauxite Co. with the Rock Island Railroad and the Missouri Pacific, Iron Mountain Railroad. The other railroad retained connects the plants of the Aluminum Co. of America at Massena, N. Y., with the New York Central and Grand Trunk Railroad lines. The public utilities excluded from the group were only of indirect benefit to the consolidation, and were admitted by the taxpayer to have been owned because of a civic duty owing to the community in which the company's plants constituted the principal industry.

The consolidated group includes corporations engaged in mining, refining, and smelting of the bauxite ores, the reduction of the ore, the production and transmission of electric power utilized in the electric furnaces, and the manufacture and sale of numerous aluminum products. The St. Lawrence Securities Co. owned the stock of the power companies at Massena and of a housing corporation for employees. The Northern Power Co. was merged with the St. Lawrence Transmission Co. in 1916 and therefore was inoperative in 1917. The Long Sault Development Co., organized to acquire

a power site on the St. Lawrence River, was dissolved in 1917, after a decision by the United States Supreme Court, in effect voiding its charter. There was also intercompany shifting of profits and expenses. The subsidiaries retained in the consolidation are deemed to meet the requirements of section 1331 of the revenue act of 1921, and T. D. 3389.

It has been noted above that the consolidated invested capital originally returned was \$64,051,029.46. In the audit letter of February 12, 1923, the invested capital was fixed at \$59,415,003.67. The present audit figure is \$63,364,999.24. While these changes are due in part to revisions of the affiliations, numerous changes have been made in the capital of a number of members of the group. Although the present figure for invested capital is less than the original return, and therefore not a cause for reduction in the amount of the excess-profits tax originally computed, since the present amount represents an increase over the figure used in February, 1923, that increase is partly responsible for the present certificate of overassessment.

The bureau has added to invested capital as returned various amounts representing charges to surplus in prior years on account of reductions in valuation of capital assets. These restorations have been made upon the basis of cost, or depreciated cost, under article 64, regulations 41. In making this adjustment to capital there has been excluded an amount of \$1,535,964.54, representing restoration of patent values, because the patents expired prior to 1917. The taxpayer claimed the right to restore such patent investments as surviving good will, in accordance with article 843, regulations 45, A. R. R. 436, 4 C. B. 392, etc. The claim has been denied, on authority of such decisions as *Union Metal Manufacturing Company* (1 B. T. A. 395;) *Winsor and Jerauld Manufacturing Company* (2 B. T. A. 22); *Providence Mill Supply Company* (2 B. T. A. 791); *Northwestern Steel and Iron Corporation* (6 B. T. A. 119); *Dexter Folding Company* (6 B. T. A. 655); *Lee Hardware Company v. United States* (T. D. 3883); *La Belle Iron Works v. United States* (256 U. S. 377, T. D. 3181, and T. D. 3877).

In the case of the American Bauxite Co., excessive depletion in prior years has been restored to invested capital in 1917.

Surplus or deficit of several subsidiaries, at acquisition by the parent corporation, has been eliminated in preparing a consolidated balance sheet at January 1, 1917.

In the audit letter of February 12, 1923, the bureau reduced the invested capital of the St. Lawrence River Power Co. by \$3,017,628.38, upon the ground that the amount represented paid-in surplus not substantiated in value. In the present audit a portion of this reduction has been restored in the amount of \$2,508,766.12. The following explanation of this adjustment is made.

In the original consolidated return, Form 1103, the taxpayer made an addition to invested capital, in schedule B, of \$2,557,278.65, described as "Invested value of subsidiaries in excess of cost of their capital stock-net." The derivation of this net figure is shown in the taxpayer's brief of March 13, 1923, page 35. The largest item is one of \$3,017,628.38, in the case of the stock of the St. Lawrence River Power Co. The taxpayer contended that the consolidated invested capital of the group should be the sum of the invested capitals of all the individual members of the group, and that the cost

of acquisition of a subsidiary's stock bore no relation to the consolidated invested capital. In other words, the taxpayer attacked the validity of that part of T. D. 2901 which was later incorporated in regulations 45 as article 867, also in T. D. 3389. The taxpayer's contention was based in part upon the case of the Regal Shoe Co., 1 B. T. A. 896, in which the commissioner has acquiesced. In S. M. 1530, III-1, C. B. 307, the Solicitor of Internal Revenue held contrary to the taxpayer's contentions, on authority of articles 864 and 867, Regulations 45. The regulations have not been changed and the bureau adheres to S. M. 1530, upon this point. Upon complaint by the company that the ruling was erroneous and had been made by the bureau without the taxpayer's having been afforded a right to be heard upon the issue, additional data and briefs were subsequently filed. The matter involves the following facts in evidence.

When a predecessor corporation, the St. Lawrence Power Co., became financially embarrassed during its construction of a hydro-electric power project on the St. Lawrence River, near Massena, N. Y., prior to 1902, its assets were sold under foreclosure of first-mortgage bonds, to a reorganization committee of three individuals, who were to form a new corporation to prosecute the power project. The committee organized the St. Lawrence River Power Co., in December, 1902, with an authorized capitalization of \$3,500,000 in preferred stock and \$3,500,000 in common stock, both of a par value of \$100 per share, for the purpose of taking over the assets acquired by the committee at the judicial sale in 1902. The Pittsburgh Reduction Co. (later the Aluminum Co. of America) had entered into a contract with the reorganization committee for the furnishing of power to its plant on terms that were particularly favorable to the aluminum manufacturer.

The assets, consisting of power property and franchises, were conveyed to the newly organized St. Lawrence River Power Co., whose stock was issued as follows:

Preferred stock, \$3,000,000 to the first mortgage bondholders of the old Power Co., for their \$2,800,000 bonds and accrued interest.

Common stock, \$1,616,720, to the second mortgage bondholders of the old Power Co., for their \$1,500,000 bonds and accrued interest.

The balance of the common stock in the new power company, together with \$300,000 of its first mortgage bonds issued in January, 1903 (out of a total issue of \$500,000) went to the holders of stock and bonds in the old power company. These bonds (of the new power company) were issued expressly subject to the lien of the above mentioned power supply contract with the Pittsburgh Reduction Co.

The power property and franchises thus acquired by the new power company were taken up on the books at a valuation of \$6,800,000, on January 19, 1903, but by April 1, 1906, had been written down to \$4,488,674.67. The power supply contract with the Pittsburgh Reduction Co. becoming impossible of fulfillment, that corporation prepared a complaint or bill in equity to compel specific performance of the contract or to force a sale of the power company's assets. The interested parties then entered into negotiations resulting in an agreement whereby certain trustees, holders of the majority of both preferred and common stock in the St. Lawrence River Power Co. agreed to sell not less than 98 per cent of the outstanding stock in the power company to the Pittsburgh Reduction Co., for \$1,450,000 face value

of the latter's bonds, or bonds of a new corporation to be organized by it (with adjustments for unobtainable shares). The Pittsburgh Reduction Co. also agreed not to assert any claim under the power supply contract, as against the holders of stock or bonds in the power company. While the Pittsburgh Reduction Co. thus was to acquire the power company's stock, it was to give up bonds of \$1,450,000 and allow its prior lien under the power supply contract to become junior to the power company bondholders' security.

Pursuant to this arrangement, the St. Lawrence Securities Co. was organized in March, 1906. At a meeting of its directors on April 12, 1906, its directors passed resolutions authorizing an issue of \$3,000,000 of bonds, and the issuance of \$1,407,000 of the bonds and \$99,000 of its (Securities Co.'s) capital stock, to the Pittsburgh Reduction Co. in exchange for \$2,800,200 in preferred and \$1,622,700 in common stock of the power company. Later in 1906 the Reduction Co. acquired 100 per cent of the power company common stock and 98.87 per cent of the preferred, for which it paid a total of \$1,439,380.80 in bonds and scrip of the Securities Co. The Pittsburgh Reduction Co. acquired the bonds and scrip in the Securities Co. by turning over to the latter the common and preferred stock in the power company. Thus the Securities Co. became the parent to the power company, and the Pittsburgh Reduction Co. became parent to the Securities Co.

In 1915, when the power company sought permission of the New York State authorities to issue (or reissue) stock of \$1,941,655 (to liquidate advances made to it by the Securities Co.), there was prepared a report by the New York Public Service Commission relating to the property of the power company at April 1, 1906. An excerpt from this report, showing the appraised value of its assets at that time, is attached to a statement dated March 31, 1927, by the taxpayer's accountants, showing valuations for canal, power plants, bridges, turbines, generators, etc., aggregating \$4,888,674.67.

The bureau has held that the Securities Co., in exchange for its own \$99,000 stock and bonds and scrip, aggregating \$1,540,716.62, issued to the Pittsburgh Reduction Co., acquired the stock of the St. Lawrence River Power Co., in April, 1906, with assets behind such stock of a value of \$4,049,482.74. This figure is determined as follows:

Fixed property, above shown.....	\$4, 488, 674. 67	
Stocks and bonds owned.....	177, 507. 71	
Miscellaneous current assets.....	14, 656. 24	
	<hr/>	\$4, 680, 838. 62
Less liabilities, bonds, and current.....		631, 355. 88
Net worth.....		<hr/> 4, 049, 482. 74

The difference between the \$4,049,482.74 and the \$1,540,716.62 or \$2,508,766.12, represents the restoration to capital in the present audit, as above noted.

One other increase has been made in the consolidated invested capital, which also affects the consolidated net income, namely, inter-company profits in inventories at January 1, 1917. In the audit of February 12, 1923, there was made a reduction to consolidated invested capital of \$1,133,420.33, representing profits on intercompany sales, prior to 1917, of goods in possession of some member of

the consolidated group at January 1, 1917. In the present audit, pursuant to S. M. 3384, IV-1 C. B. 277, the intercompany profits in inventories at January 1, 1917, have been restored to invested capital. (The amount shown in the schedule supporting the certificate of overassessment is \$1,217,526.80, which includes an amount of \$84,106.47 increase in overhead in inventories.) These intercompany profits result from sales of products between affiliated corporations, at an advance over cost.

In considering the effect of intercompany profits in inventories upon the consolidated net income, in the audit of February 12, 1923, there was a reduction to the consolidated net income of \$476,828.37, arrived at thus:

Decrease in 1917 closing inventories due to changes in overhead and elimination of intercompany profits.....	\$1, 725, 347. 22
Decrease in 1917 opening inventories due to changes in overhead and elimination of intercompany profits.....	1, 133, 420. 33
Total adjustment to consolidated net income.....	591, 926. 89
Less decreases already taken up in the audit for increases due to overhead.....	115, 098. 52
	<hr/> 476, 828. 37

In the present audit, there has been made a reduction to consolidated net income of \$1,694,355.17 for intercompany profits in closing inventories, determined as follows:

Total decrease due to adjustments to closing inventories for overhead and intercompany profits.....	\$1, 725, 347. 22
Less net decrease due to overhead separately taken up.....	30, 992. 05
Net decrease due to intercompany profits.....	<hr/> 1, 694, 355. 17

There has been added to consolidated net income an item of \$126,929.37, representing a loss on liquidation of the Long Sault Development Co. to its parent, the St. Lawrence Securities Co. This amount has not, however, been subjected to the income-tax rates, but has been deducted from the gross income of the St. Lawrence Securities Co.

The consolidated excess-profits tax now computed has been so allocated as to avoid issuance of small certificates of overassessment to four of the subsidiaries, and those changes taken into consideration in allocating the balance of excess-profits tax to the parent company. The results of this allocation and revised tax computations are shown in the certificates of overassessment above stated.

The overassessment certificates are supported by waivers and claims as shown below.

In the case of the parent company, the return was filed on April 1, 1918. Waivers for assessment were filed by it as follows:

Dated March 13, 1923, running for one year from date.

Dated January 31, 1924, running for one year after expiration of the prior waiver.

Dated January 12, 1925, running to December 31, 1925.

Dated December 8, 1925, running to December 31, 1926.

Dated December 6, 1926, running to June 30, 1927.

Dated June 20, 1927, running to October 31, 1927.

Dated August 1, 1927, running to December 31, 1927.

Dated November 21, 1927, running to March 31, 1928.

Dated March 9, 1928, running to June 30, 1928.

On June 19, 1923, the taxpayer filed a claim for the abatement of \$498,514.42, which was the amount of the additional assessment made in March, 1923, as above noted. The claim was based on the bureau's failure to accord the company a hearing, under section 250 (d) of the revenue act of 1921. On March 1, 1924, it filed a claim for the refund of \$769,040.73, based upon its appeal or letter of May 24, 1923, loss of land value, intercompany profits in inventories, and any tax reductions resulting from changes to net income or capital of affiliated corporations. On June 3, 1924, the taxpayer filed a further claim for refund of \$789,254.30, including an amount of \$767,098.96 for 1917, and the balance being applicable to 1918, 1919, and 1920. In this claim, tax reduction was based upon the intercompany profits in inventories, an issue raised also in claims for refund and credit filed in 1921.

On April 1, 1926, a claim was filed for the refund of \$6,153,724.66, the amount of the original assessment. This claim was designed to protect the taxpayer against the running of the statute of limitations, but was based specifically on the grounds that in the letter of February 12, 1923, there was erroneously included in net income \$8,170.73 for discount on construction and equipment, and \$56,-832.68 for an inventory adjustment; that the following four items were erroneously excluded from invested capital: \$215,362.98 investment in the Aluminum Ore Co., \$166,030.80 investment in the Electric Carbon Co., \$849,995.80 dividend payments deducted in the return, and \$604.44 adjustment of stock purchase account; that intercompany profits of \$1,694,355.17 in the 1917 closing inventories were erroneously included in consolidated net income; that certain contributions made to American Red Cross, Knights of Columbus, and Y. M. C. A. War Fund were erroneously disallowed as deductions; that the consolidated invested capital was understated by \$677,-233.08 on return form 1103; that loss of useful value (on certain power site lands of the Long Sault Development Co.) in the amount of \$373,149.03 should be allowed for 1917; that additional depreciation should be allowed on assets previously not capitalized; and that a loss of \$116,584.21 deducted in 1918, on shipments of aluminum by L. Vogelstein & Co., should be allowed in 1917. Under section 284 (g) of the revenue act of 1926, when waivers have been filed for 1917, as in this case, a refund claim might be filed at any time, before April 1, 1926. While all the grounds of the claims have not been allowed, the allowances made are supported by timely claims.

The five subsidiaries, to which certificates of overassessment are to be issued, filed waivers at the times above stated, in connection with the parent company, and covering the same period.

The Aluminum Cooking Utensil Co. filed its 1917 return on April 1, 1918. The certificate of overassessment is for a sum less than the assessment made in March, 1923, and is based upon claims for abatement of \$3,413.46, filed March 31, 1923, and for refund of \$157.31, filed March 1, 1924, and of \$105,174.96, filed April 1, 1926.

The Aluminum Ore Co. filed its 1917 return on April 1, 1918. The certificate of overassessment to it is less than the additional tax assessed in March, 1923. Claims were filed for abatement of \$6,-155.37 on March 31, 1923, for refund of \$25,858.87 on March 1, 1924, and for refund of \$642,273.54, on April 1, 1926. The allowances are based on the grounds of these claims.

The American Bauxite Co. filed its return on April 1, 1918. The allowance of the certificate of overassessment is based upon grounds set up in refund claims, of which one for \$68,373.90 was filed March 1, 1924, and one for \$441,272.96 was filed on April 1, 1926.

The Electric Carbon Co.'s 1917 return was filed on April 1, 1918. The certificate of overassessment is for a less amount than the additional tax assessed in March, 1923. A claim for abatement of \$749.93 was filed March 31, 1923, and claims for refund were filed on March 1, 1924, for \$1,587.11, and on April 1, 1926, for \$88,746.16.

The St. Lawrence River Power Co. filed its return on April 1, 1918. While the overassessment certificate slightly exceeds the amount of additional tax assessed in March, 1923, there was filed, on March 31, 1923, a claim for abatement of \$430.03. A claim for refund of \$138,506.06 was filed on March 1, 1924, and a claim for refund of \$138,506.06 on April 1, 1926. These claims sustain the allowance of overassessment.

In the case of the Aluminum Cooking Utensil Co., Aluminum Ore Co., Electric Carbon Co., and the St. Lawrence River Power Co., under date of September 12, 1927, collection waivers, expiring December 31, 1928, were filed in the amounts of the additional assessments made in March 1923, against these four companies.

It is recommended that the overassessments be allowed.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved June 19, 1928.

H. F. MIRES,

Acting Commissioner of Internal Revenue.

APPENDIX 11

IN RE CADILLAC CHEMICAL CO., MITCHELL-DIGGINS IRON CO., CADILLAC, MICH.

OFFICE OF THE GENERAL COUNSEL

(OF INTERNAL REVENUE,

July 30, 1928.

MR. COMMISSIONER: Certificates of overassessment have been prepared and scheduled in favor of the above-named corporations as follows:

Name	Year	Amount	Schedule
Cadillac Chemical.....	Fiscal year Sept. 30, 1918....	\$23,509.37	29968
Mitchell-Diggins Iron Co.....	1917.....	84,127.38	27987
Do.....	Jan. 1 to Sept. 30, 1918.....	113,665.13	29968

The credits or refunds are to be made in accordance with section 284 of the revenue act of 1926.

The overassessment in favor of the Cadillac Chemical Co. for the fiscal year ended September 30, 1918, is due to computing the profits tax under section 328 of the revenue act of 1918.

The Cadillac Chemical Co. was organized in 1904 by Cobbs & Mitchell (Inc.) and the Mitchell Bros. Co., these companies retaining ownership of 75 per cent of the stock, the remainder being held by

various other parties. The Mitchell-Diggins Iron Co. was organized in 1905, the Cadillac Chemical Co. holding in excess of 80 per cent of the stock issued. Cobbs & Mitchell (Inc.), and the Mitchell Bros. Co. engaged in the lumber business.

The Cadillac Chemical Co. was organized for the purpose of utilizing material left in the woods in the course of lumber operations of its organizers. The Mitchell-Diggins Iron Co. was organized to utilize charcoal manufactured by the chemical company. In launching the chemical company a contract was made between it and the lumber companies providing that the lumber companies were to furnish necessary wood, fuel, power, and office service, in payment for which they were to receive 41 per cent of the gross income of the chemical company. Payment for wood was to be made on delivery, the balance of the 41 per cent to be adjusted at the end of the year. The wood price was subject to adjustment at 6-month intervals on the basis of market prices of wood alcohol, charcoal, and acetate of lime.

The unit has ruled that the Cadillac Chemical Co. and the Mitchell-Diggins Iron Co. are affiliated for the fiscal year ended September 30, 1918, and subsequent years, but has eliminated from the affiliation Cobbs & Mitchell (Inc.), and the Mitchell Bros. Co.

The taxpayer contends that due to the fact that the two branches were operated practically as departments of the lumber companies there was no attempt to make a distinct division of expenses involved in transactions between the lumber companies and the chemical company. The lumber companies prepared the wood, held the wood during the seasoning period, delivered the wood to the taxpayer, and furnished power, fuel, and office service. In short, while the taxpayer was a separate company, the association was so close that the necessity for segregation of the expenses was not realized, with the result that there appears to be a distortion of net income.

The abnormality in the instant case lies in the form of organization, which was such that the taxpayer operated and earned income largely with the assets which were owned by its principal stockholders and which are not represented in its invested capital. In this connection it is noted that the return on invested capital for 1918 was 382 per cent.

After careful consideration of all the facts it appears that there exist in the instant case such abnormal conditions as section 328 of the revenue act of 1918 was designed to remedy.

In determining whether or not the abnormal conditions noted above result in a hardship, careful consideration has been given concerns engaged in the wood-distillation industry in the New York-Pennsylvania and Tennessee regions, as well as Michigan. Data sheets have been prepared, in which have been used concerns which are comparable in all essential factors. These comparisons clearly indicate that the abnormal condition noted above results in an exceptional hardship.

The special advisory committee has had under consideration the advisability of granting special assessment and has recommended that the profits tax for the fiscal year ended September 30, 1918, be computed under the provisions of section 328 of the revenue act of 1918 at the following rates:

	Per cent
1917 portion of fiscal year ended Sept. 30, 1918.....	41. 91
1918 portion of fiscal year ended Sept. 30, 1918.....	47. 08

This office is in accord with the findings of the committee.

The overassessment in favor of the Cadillac Chemical Co. for the fiscal year ended September 30, 1918, in the amount of \$23,509.37 follows the action taken with respect to the fiscal years ended September 30, 1917, 1919, and 1920, passed upon by the United States Board of Tax Appeals, where in the board—

Ordered and decided that, upon redetermination, there are overpayments for the fiscal years ended September 30, 1917, 1919, and 1920, in the amounts of \$27,534.03, \$8,826.02, and \$31,884.21, respectively.

Docket 25876.

MITCHELL-DIGGINS IRON CO.

For the year 1917 the Mitchell-Diggins Iron Co. rendered a return disclosing a net income of \$249,906.55, upon which a tax of \$122,674.30 was assessed. As the result of an audit, net income has been decreased by \$116,651.55 to \$133,255, the deduction for taxes being understated by \$133.50; additional depreciation in the sum of \$415.29 has been allowed, and there has been allowed as a deduction \$116,102.76, representing deferred charcoal payments. With respect to the last item the Mitchell-Diggins Iron Co. claimed deductions of \$64,223.50 and \$51,879.26 in the years 1912 and 1915, respectively, as deferred charcoal charges, which amounts were disallowed in those years. Mitchell-Diggins Iron Co. purchased under contract charcoal from the Cadillac Chemical Co. During the years prior to 1917 the iron company was not prosperous and the chemical company temporarily lowered its rates for charcoal; but during 1917, when the iron company's earnings had increased, there was a payment made by the iron company to the chemical company in the nature of accrued charges on charcoal. This office ruled on October 6, 1921 (S. I. M. 670), that this represented income taxable to the chemical company in 1917, rather than in the years when the charcoal was delivered and used. The present adjustment of the iron company accepts the converse of the proposition and allows the payment as a deduction from 1917 income.

The invested capital as reported in the original return, \$299,921.03 has been increased to \$403,955.43, a net increase of \$104,034.40, due primarily to income adjustments made in prior years, the principal adjustment being the disallowance of deferred charcoal payments as deductions in the years 1912 and 1915, which item has been previously referred to. There were other minor adjustments made whereby invested capital was both increased and decreased, the net result being an increase of \$104,034.40. The above adjustments result in an over-assessment of \$84,127.38.

The overassessment for the period January 1 to September 30, 1918, is due to the unit ruling that the above-named taxpayer is affiliated with the Cadillac Chemical Co. for the period January 1 to September 30, 1918, within the purview of article 633, regulations 45, and section 240 of the revenue act of 1918, and requiring that the income be computed upon the basis of a consolidated return as required by article 632 of regulations 45.

Mitchell-Diggins Iron Co. was organized in 1905, the Cadillac Chemical Co. holding in excess of 80 per cent of the stock issue. Originally a return was rendered by the Mitchell-Diggins Iron Co. for the calendar year 1918 disclosing a net income of \$404,101.78. Income of the Mitchell-Diggins Iron Co. has now been ascertained

on the basis of the period January 1 to September 30, 1918, the correct net income for this period being \$406,230.49. The combined income of the Cadillac Chemical Co. and the Mitchell-Diggins Iron Co., after eliminating intercompany items, is \$794,879.10. The profits tax has been computed under Section 328 of the revenue act of 1918 in accordance with recommendation made by the special advisory committee more fully set forth above. The total profits and income tax at 1918 rates applicable to the 1918 portion of the year has been ascertained to be \$370,759.42, of which amount \$189,480.11 has been allocated to the Mitchell-Diggins Iron Co., and as \$303,145.24 was assessed on the original return, an over-assessment of \$113,665.13 results.

In view of the above it is recommended that the overassessments be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: July 31, 1928.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 12

IN RE CADILLAC CHEMICAL CO., CADILLAC, MICH.

August 20, 1928.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund in the above-named taxpayer's case for the fiscal year ended September 30, 1918, together with the proposed refund in the case of the Mitchell-Diggins Iron Co. for the period January 1 to September 30, 1918. The above-named cases for the years mentioned are a portion of the case of the above-named taxpayer audited by the unit, which were appealed to the United States Board of Tax Appeals and docketed under No. 25876. The cases covering the years 1917, 1918, 1919, and 1920 were recalled by the special advisory committee, resulting in a stipulation of the case.

The action of the advisory committee in conceding the issues involved is shown by the attached memorandum prepared by that committee. It should be noted that two issues were involved—first, affiliation; second, claim for special assessment. It is obvious from the recommendation of the advisory committee that the taxpayer had no grounds for appeal on the basis of affiliation. The basis of the advisory committee in conceding special assessment is fully set forth in its memorandum, copy of which is attached.

On the basis of facts on file in this report, I am not in agreement with the conclusions reached. The reasons for this disagreement are as follows: The advisory committee states that the "abnormality in the instant case lies in the form of organization, which was such that the appellant operated and earned income largely with the

assets which were owned by its principal stockholders and which are not represented in its invested capital." The facts seem to be that the appellant company, at the time of its incorporation, entered into a contract with Cobbs & Mitchell (Inc.), and the Mitchell Bros. Co., two corporations, neither of which are affiliated with the taxpayer nor with each other. Under such circumstances, this contract must be presumed to have been a contract entered into under the circumstances of free bargaining. The fact that these two companies own approximately 66 per cent of the stock of the appellant does not, in any manner, create an abnormality as contemplated by sections 327 and 328 of the revenue act of 1918. It seems true that the contract was a profitable one to the taxpayer, resulting in rather large profits for the years under consideration, but there is a clear-cut line of decisions holding that excessive profits are not a basis for special assessment. If there is any factor of abnormality in the facts as enumerated by the attached memorandum, I have been unable to detect them.

This conclusion is given you from the file which has been transmitted to me. Whether or not it contained all the evidence before the committee when the case was decided, I am unable to tell. The 30-day period for this refund will expire on September 1. The above memorandum is given you for your file in order that it may be complete, since it is apparent that there is not sufficient time in which this committee might criticize the action of the bureau.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 12(A)

IN RE CADILLAC CHEMICAL CO.

TREASURY DEPARTMENT,
Washington, June 11, 1929.

MR. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: In connection with the allowance of an over-assessment in favor of the above-named company, it is desired to submit the following information, particularly in regard to the nature of the abnormalities found to exist in both the taxpayer company's income and statutory capital.

As stated in the memorandum submitted with a copy of the proposed certificate, the Cadillac Chemical Co. was organized in 1904 by Cobbs & Mitchell (Inc.), and the Mitchell Bros. Co., these companies retaining ownership of 75 per cent of the stock, the remainder being held by various other parties. The Mitchell-Diggins Iron Co. was organized in 1905, the Cadillac Chemical Co. holding in excess of 80 per cent of the stock issued. Cobbs & Mitchell (Inc.) and the Mitchell Bros. Co. engaged in the lumber business.

The Cadillac Chemical Co. was organized for the purpose of utilizing material left in the woods in the course of lumber operations of its organizers. The Mitchell-Diggins Iron Co. was organized to utilize charcoal manufactured by the chemical company. In launching the chemical company a contract was made between it and the

lumber companies providing that the lumber companies were to furnish necessary wood, fuel, power, and office service, in payment for which they were to receive 41 per cent of the gross income of the chemical company. Payment for wood was to be made on delivery, the balance of the 41 per cent to be adjusted at the end of the year. The wood price was subject to adjustment at 6-month intervals on the basis of market prices of wood alcohol, charcoal, and acetate of lime.

The stock ownership during the years under review was approximately as upon incorporation, and the Cadillac Chemical Co. and the Mitchell-Diggins Iron Co. have been ruled affiliated for the fiscal year ended September 30, 1918. The operations of all of the companies were supplementary to each other, and in that sense the group formed a business unit. The stock ownership in the Cobbs & Mitchell (Inc.) and in the Mitchell Bros. Co. did not meet the statutory requirement of substantially all and the taxpayer companies were not affiliated with those two companies within the purview of section 240 of the revenue act of 1918 or section 1331 of the revenue act of 1921.

A review of the accounting records of the several companies has established that the taxpayer companies were operated practically as branches of the lumber companies, no attempt being made to segregate expenses accurately or to have the acquisition of capital assets made by and recorded in the books of the company using them. As a result of the majority co-ownership of the several companies by the same interests an accurate reflection of book income by each company was not desired and an arbitrary shifting of expenses in the instant case results in abnormalities in the taxpayer companies' incomes. Similarly the taxpayer companies employed in their operations capital assets which the co-owners of all the companies had acquired in the name of another company. This abnormality in the taxpayers' invested capital is further evidenced by the extraordinary ratio of taxable income to statutory capital, which was 247 per cent in 1917, and 382 per cent in 1918.

It is the opinion of the bureau that the arbitrary assignment of income and capital to the nonaffiliated members of the economic group by the joint stockholders of all of the companies produced abnormalities of income and capital in the case of the taxpayer companies, which abnormalities warranted the application of section 210 of the revenue act of 1917 and 327 and 328 of the revenue act of 1918 in the determination of the profits tax liabilities of these companies.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 13

IN RE CLEVELAND CLIFFS IRON CO., CLEVELAND, OHIO

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
July 20, 1928.

MR. COMMISSIONER: A certificate of overassessment in the amount of \$191,997.27 in favor of the above-named taxpayer for the year 1918 is herewith submitted for approval.

The taxpayer at the time of the entry of the United States into the war was the owner of a number of iron mines and a number of coal mines and owned besides the operating mine ore reserves which were of poor quality. The taxpayer was requested by the United States Government to develop its production of iron ore and coal to the fullest extent and to that end after April 6, 1917, expended considerable sums not only in the further development of its operating mines, but also in the development of its poor ore reserves as operating mines. The taxpayer also was the owner of large tracts of timber land. After April 6, 1917, considerable sums were expended in developing its facilities for the logging of timber from its timber lands and in developing its facilities in the distillation of products from its timber productions. Since all of the products of the taxpayer were products which were necessary in the prosecution of the war there is no doubt but that the additional facilities installed after April 6, 1917, are subject to amortization under the provisions of section 234 of the act of 1918.

On the original return for the year 1918 amortization was deducted in the amount of \$900,180.44. Of the amortization deducted \$773,270.02 was amortization applicable to the iron mining and coal mining facilities and the timber production and distillation facilities. The balance of the amortization deducted was the amortization computed upon the additional railroad facilities acquired by the two railway subsidiaries of the taxpayer. In the amortization as finally allowed no amount has been allowed as the amortization of the additional facilities acquired by the railway subsidiaries. All of the amortization as finally allowed is the amortization determined upon the facilities of the iron mines, coal mines and timber production and distillation facilities.

Amortization was claimed by the taxpayer on total costs in the amount of \$7,450,858.82. On these total costs amortization was claimed in the amount of \$4,154,210.27. The amortization engineers have considered the amortization claim of the taxpayer and by report dated November 28, 1927 have determined the amortization allowable. Of the total amortizable costs on which amortization was claimed there has been disallowed as not subject to amortization costs in the total amount of \$2,835,258.51 and the amortization as determined is allowed on the balance of amortizable costs in the amount of \$4,615,600.31. The amortization allowed is computed upon three bases. As to such additional facilities installed after April 6, 1917 as were abandoned after the war period the amortization is based on residual cost after deduction of the salvage value and post war depreciation. As to such facilities as were in full use in the postwar period amortization has been computed upon the estimated cost of replacement under normal postwar conditions less depreciation as applicable under the provisions of article 184 (2) of Regulations 62. As to such facilities as were not abandoned and were not in full use in the postwar period amortization has been computed upon the basis of a postwar value in use computed according to the ratio which the production of the postwar year in which there was the maximum production of the postwar period bears to the maximum capacity as determined by the war period. The date of cessation of operation as a war facility was December 31, 1918 and accordingly all the amortization applicable to the facilities installed in time for use prior

to December 31, 1918 has been allocated to the year 1918. Only such amortization as is allowed on amortizable costs incurred in the year 1919 after the cessation of operation as a war facility has been allocated to the year 1919. Amortization has been allowed on the facilities acquired after April 6, 1917 in the total amount of \$1,761,651.09 whereof there has been allocated to 1918 the amount of \$1,614,949.14 and the balance, namely, \$146,701.95, has been allocated to 1919. Since there was deducted on the original return a total amortization of \$900,180.44 the increase of amortization as now allowed for the year 1919 is \$714,768.70.

The net income as reported on the original return and as again reported on the amended return without change was \$3,879,292.03. The net income as finally determined is \$3,696,341.98. There have been adjustments other than amortization which other adjustments have served to increase the taxable income so that notwithstanding the allowance of the additional amortization as stated the deduction of net income as finally determined over the net income as reported is not more than \$182,950.05. This reduction of net income is in part the cause of the overassessment above mentioned.

This taxpayer is a corporation organized under the laws of West Virginia in the year 1891. During the period of its existence and prior to the taxable year the taxpayer acquired the capital stocks of several corporations and later acquired the assets of these corporations. In the year 1914 three of the corporations whose capital stocks had been acquired prior thereto were liquidated. These three corporations were the Jackson Iron Co., the Cleveland Iron Mining Co., and the Iron Cliffs Co. In the year 1916 the Pioneer Iron Co. whose capital stock had been theretofore acquired was liquidated. At the time of the liquidation of these corporations the taxpayer in return for the surrender and cancellation of the capital stocks of the liquidated corporations acquired all of the assets of those corporations. The assets acquired from the liquidated corporations at the time of their dissolution and liquidation were not entered upon the books of this taxpayer at their true value. They were entered upon the books of this taxpayer in amounts which were either the cost of acquisition of the capital stocks of these corporations or a much less amount. Since the corporations liquidated in the year 1914 and in the year 1916 were all liquidated prior to the year 1917 and their assets were acquired by this taxpayer prior to the year 1917, this taxpayer is entitled to include as a part of its statutory invested capital the values which are representative of the values of the assets at the time of the liquidation of the corporations and the acquisition of the assets. The assets acquired from the corporations liquidated in the years 1914 and 1916 have all been evaluated by the engineers of the bureau. The engineers of the bureau have determined the values of the assets acquired as of March 1, 1913, and have by computations and deduction of the depreciation and depletion applicable to those assets in the period between March 1, 1913, and the time of liquidation determined the true values as of the time of acquisition by this corporation from the liquidated corporation. The values so determined as of the time of the liquidation have been included in the invested capital of the taxpayer as of the time of the acquisition of the assets from the merged corporations. The inclusion of the assets acquired from the

liquidated corporations at their real values as of the time of acquisition from the liquidated corporation is in accordance with the principles stated in L. O. 1108.

This taxpayer was conservative in its accounting and in years prior to the profits-tax year had written down upon its books many of its investments in securities and in plant property. These investments have been considered by the bureau and the costs of these assets have been restored by additions to the book surplus as of December 31, 1916, of such amounts as are necessary to state the investments at their original costs less such depreciation or depletion as is applicable. These additions are in accordance with the principles stated in articles 840 and 841 of regulations 62.

On the original return the taxpayer in Schedule 2 included as adjustments by way of additions from Schedule F the amount of \$19,718,173.56. On its amended return the taxpayer included as adjustments by way of additions from Schedule F the amount of \$8,089,518.03. After the determination of the original costs of assets acquired by this taxpayer either directly or by the liquidation of the merged corporations it has been determined that additions should be made to the book surplus as of December 31, 1916, in respect to the properties received from the merged corporations, namely, Cleveland Iron Mine Co., Iron Cliffs Co., Pioneer Iron Co., and Jackson Iron Co. in the amounts of \$2,991,910.77, \$6,922,995.29, \$659,358.68, and \$311,002.98, respectively. It has also been determined that the taxpayer is entitled to a restoration of costs of other securities and plant investments owned by the taxpayer in the total amount of \$4,140,260.62. These restorations and additions aggregate \$15,025,528.34.

After other adjustments on account of depletion and depreciation it has been determined that the taxpayer is entitled to a net additional value upon its books as of December 31, 1917, in the amount of \$14,747,738.63. The invested capital as reported on the original return was \$54,509,400.16. The invested capital as reported on the amended return was \$43,301,522.30. The reduction of the invested capital on the amended return resulted in a computation of a profits tax on the amended return in the amount of \$123,651.08, whereas no profits tax was disclosed on the original return. After adjustment it has been determined that the minimum invested capital to which the taxpayer is entitled is \$48,570,281.65, which is an increase of \$5,268,759.35, over the invested capital reported on the amended return. The corrected invested capital as above stated is the minimum statutory invested capital. In this statement of invested capital some adjustments for the taxpayer's benefit have not been made, since such adjustments appear unnecessary in view of the fact that the minimum capital as stated produces excess profits and war profits credits which are larger than the corrected net income.

The adjustment of the invested capital whereby the statutory invested capital is determined to be greater than the invested capital stated on the amended return is the principal cause of the overassessment, since by that adjustment profits taxes are eliminated. The reduction of income is in part the cause of the overassessment.

Claims have been filed by the taxpayer so that the overassessment is not barred.

It is accordingly recommended that the overassessment above indicated be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: July 23, 1928.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 14.

IN RE CLEVELAND CLIFFS IRON CO., CLEVELAND, OHIO

AUGUST 29, 1928.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund in the above-named taxpayer's case, for the calendar year 1918, in the amount of \$191,997.27, as shown by Certificate of Overassessment No. 337562.

The refund in the above case is due to two causes: First, increase in invested capital; second, allowance of additional amortization.

The first of these resulted from the fact that capital stock of various companies was acquired, after which the companies were liquidated and the assets taken over by the taxpayer. Following the period of the acquisition of these assets, conservative methods of accounting resulted in the writing down of these assets. The taxpayer claimed as invested capital the actual value of these assets at the time acquired, as provided by Law Opinion 1108 and section 326 of the revenue act of 1918. An examination of the file indicates that the values were established by appraisal engineers, supplemented by an examination of the records of the taxpayer. Additional values added to invested capital over the amount shown on the return approximate \$15,000,000.

The data indicate the determination has been made with due regard to accuracy and reasonableness. It would appear, therefore, that the invested capital allowed is reasonable.

AMORTIZATION

The taxpayer claimed approximately \$900,000 amortization on its original return. Claim was later made on increased cost of assets, resulting in a final allowance of \$1,614,949.14 for the year 1918 and \$146,701.95 for the year 1919. The amount allowed, a great proportion of which is based upon assets retained in use, was arrived at by the application of the Manville Jenckes principle to the case.

The end of the war period is December 31, 1918. It would appear, from a reading of the decisions by the Board of Tax Appeals in the case of the United States Refractories Corporation, Docket Nos. 5642 and 12355, and the decision in the case of William Silver & Co., Docket No. 9708, that all the amortization proposed in this case

should be deducted from the income for the taxable year 1918, whereas the bureau has allocated approximately \$146,000, mentioned above, to the year 1919. There is no excess-profits tax for either the year 1918 or 1919. For that reason, the net error in allowing the amortization over the years 1918 and 1919 rather than in 1918 only, is negligible.

It is, therefore, recommended that no criticism be offered to the proposed refund.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 15

IN RE JOHN D. ROCKEFELLER, SR., NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE, *July 13, 1928.*

MR. COMMISSIONER: A certificate of overassessment in the amount of \$120,655.28 for the year 1922 has been submitted to this office for review in the case of the taxpayer named above.

The refund or credit involved is to be made in accordance with the provisions of section 284 (b) of the revenue act of 1926.

The individual return reported a taxable net income of \$325,993.95. In the present determination the income has been increased by \$43,121.95 and decreased by \$291,786.16, resulting in a net reduction of \$248,664.21 as explained below.

The addition to net income of \$43,121.95 represents an adjustment for donations. The unit has determined that of the total donations deducted on the return, the amount eliminated in the present determination should be considered taxable income. The taxpayer has indicated his acquiescence as to the increase to income.

The overassessment for this year is due to the reduction of net income in recomputing the profit realized on certain shares of stock, as hereinafter described. Prior to October 1, 1902, the taxpayer purchased from the Everett Timber & Investment Co. its entire capital stock, consisting of 3,500 shares of common stock. A total cash consideration of \$350,000 was paid for the stock. The 3,500 shares of stock were sold on May 18, 1922, to John D. Rockefeller, jr., for \$4,947,000. In the return the taxable gain was computed at \$1,056,990.03, using as a basis the March 1, 1913, value of the stock sold, which value was based upon the corporation's net assets at March 1, 1913, consisting almost entirely of the timberlands and timber. Upon examination it was found that in arriving at the taxable gain the March 1, 1913, value of the stock, determined as just stated, had been reduced by \$291,786.16, representing the March 1, 1913, value of certain timber sold by the corporation in 1920 for \$502,070. Obviously such a sale by the corporation represented merely a conversion of corporate assets, and was not a liquidation or return of capital to the stockholder of the vendor corporation. Therefore the March 1, 1913, value of the stockholder's stock was unaffected by the sale and should not have been reduced by the \$291,786.16 item. Increase of basis reduces the taxable gain accordingly. The timber was cruised in the years 1912-1915, and has been the subject of an engineer's

report in the bureau, accepting the taxpayer's valuation figure at March 1, 1913.

In view of the foregoing, it is recommended that the overassessment above indicated be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: July 16, 1928.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 16

IN RE STANDARD OIL CO. (KENTUCKY), LOUISVILLE, KY.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
July 31, 1928.

MR. COMMISSIONER: Certificates of overassessment of corporation income and profits taxes in favor of the above-named company have been prepared for the years 1919, 1920, and 1921 in the amounts of \$564,128.06, \$992,654.52, and \$281,884.83, respectively.

The above overassessments are due entirely to the allowance of assessment under the provisions of sections 327 and 328 of the revenue act of 1918. The audit on a statutory basis does not disclose a tax liability substantially different from that indicated on the original returns. For the year 1919 the tax liability assessed on the basis of the original return was \$1,385,657.39. Of this original assessment a net amount of \$6,948.51 has been refunded on the basis of a statutory audit. The adjustments resulting in this refund are principally in connection with the allowance of depreciation and changes of a minor nature in the deductions claimed on the return. For the year 1920 the tax liability indicated on the original return of \$2,205,016.67 has been reduced by a refund in the net amount of \$6,823.20 as a result of a statutory audit. The tax liability indicated on the original return for the year 1921 of \$670,931.67 has been increased by an additional assessment on the basis of a statutory audit in the amount of \$14,726.05. As above stated the entire present overassessments are due to the allowance of special assessment. The result of the allowance of special assessment is indicated in the following schedule:

Year	Income	Profits tax liability		Percentage ratio of profits tax to income	
		Sec. 301	Secs. 327-328	Sec. 301	Secs. 327-328
1919.....	\$4, 036, 754. 00	\$1, 084, 640. 00	\$457, 831. 08	\$26. 87	\$11. 34
1920.....	6, 041, 260. 00	1, 772, 988. 00	670, 246. 86	29. 35	11. 10
1921.....	3, 094, 526. 00	418, 003. 00	104, 802. 73	13. 51	3. 39

The taxpayer was organized in 1886 under the laws of the State of Kentucky as a subsidiary of the Standard Oil Co. of New Jersey. The charter granted expired in 1911 and in that year a new charter was granted the taxpayer and in the same year the Standard Oil

Co. of New Jersey surrendered its stock in the taxpayer and the stock so surrendered was reissued to individual holders so that from that date through the taxable years under review the taxpayer has not been affiliated with the New Jersey corporation.

Prior to the reorganization in 1911 the Standard Oil Co. of New Jersey exercised a complete control over the taxpayer and directed all of the details of the conduct of the taxpayer's business. The accounts of the taxpayer were kept in accordance with general instructions issued by the New Jersey company and entries were made on the books in accordance with special instructions issued at various times. As a result of this method of keeping the books capital expenditures were charged to expense throughout the period of control by the New Jersey company. Additions to buildings, costs of barrel cars, barrel runs, barrel fillers and hose, brokerage for buying land, architects fees and other expenses of buying and selling land and numerous other items of a similar nature were charged to expense instead of being capitalized. There were a number of transfers of property from the Kentucky company to the New Jersey company and from the New Jersey company to the Kentucky company without regard to actual values. Depreciation was not computed on any recognized basis but was charged in order to reduce the actual income to a book income which would be satisfactory for dividend purposes. The capital account of the taxpayer, therefore, does not reflect the actual investment and due to the poor accounting records maintained in earlier years as well as to the destruction of important records, it is impossible to satisfactorily determine the true statutory capital in accordance with the provisions of section 326 of the revenue act of 1918.

The taxpayer developed very valuable sales stations and sales routes. All of the costs of the development of these sales outlets were charged to expense. It is noted that for the years 1906 to 1910 the average book income was approximately \$500,000 and the average capital stock and surplus approximately \$4,000,000. Dividends were paid during the same period of an average of about \$800,000 per year. The yearly dividends paid over the period 1902 to 1911 were approximately 110 per cent of the capital stock outstanding each year. The same comparative figures exist with respect to any 5-year period from 1900 to the profits-tax years. This review of the taxpayer's financial history substantiates the claim that the large expenditures made in the development of sales routes should have been capitalized instead of being charged to expense and that the invested capital reflected by the books does not include the actual investment made by the taxpayer for capital assets owned and used during the years under review.

The impossibility of determining statutory capital is supported by the history of the reorganizations effected and absence of records as described in the taxpayer's brief sworn to June 20, 1928.

In the preparation of data sheets for the years 1919, 1920, and 1921 the comparison of the taxpayer with representative companies further substantiates the taxpayer's claim that its invested capital is substantially understated on its books. It is noted that the percentage ratio of net income to adjusted invested capital for the taxpayer is more than twice that of the percentage of the average comparative concerns. Since the taxpayer's ratio of net income to gross

sales and cost of sales to gross sales is substantially the same as the percentage ratios for the comparative companies the excessive profits tax paid by the taxpayer is clearly traceable to the understatement in its statutory invested capital. The percentage ratios for the taxpayer and the average comparative concerns are indicated in the following schedules:

	1919		1920		1921	
	Tax- payer	Average corpora- tions	Tax- payer	Average corpora- tions	Tax- payer	Average corpora- tions
Percentage ratio, net income to gross sales.	8. 76	10. 91	9. 19	9. 13	5. 97	10. 65
Percentage ratio, cost of sales to gross sales.	80. 31	78. 08	81. 06	82. 38	81. 47	76. 27
Percentage ratio, net income to adjusted invested capital.....	42. 70	17. 06	52. 62	17. 25	21. 15	9. 64

In the selection of comparative concerns the Income Tax Unit has used companies engaged in the refining and distribution of petroleum, which is the type of business conducted by the taxpayer. In addition comparative concerns have been selected which are as nearly as may be similarly circumstanced to the taxpayer with respect to gross income, net income, profits per unit of business transacted, capital employed, the amount and rate of war profits and excess profits, and all other relevant facts and circumstances.

In view of the foregoing it is recommended that the overassessments above indicated be allowed.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved: August 13, 1928.

H. F. MIRES,

Acting Commissioner of Internal Revenue.

APPENDIX 17

IN RE STANDARD OIL CO. OF KENTUCKY, LOUISVILLE, KY.

SEPTEMBER 11, 1928.

Mr. L. H. PARKER,

Chief, Division of Investigation,

Joint Committee on Internal Revenue Taxation,

Washington, D. C.

MY DEAR Mr. PARKER: Pursuant to your written instructions, I have made an examination of the above-named taxpayer's case in connection with proposed refunds for the years 1919, 1920, and 1921 in the following amounts:

1919.....	\$564, 327. 88
1920.....	992, 654. 52
1921.....	281, 884. 83

BASIS OF REFUND

The refund is due, in a large measure, to the allowance of special assessment. The grounds on which the taxpayer laid claim to special assessment are set forth in a memorandum dated July 23, 1927, prepared by the auditor of the case. This memorandum sets forth 12

specific reasons for the allowance of special assessment. These reasons cover almost every imaginable ground upon which a claim for special assessment could be made. A review of the case, however, indicates there is sufficient merit to the taxpayer's claim as to establish beyond a question of doubt that the company is entitled to special assessment.

COMPARATIVES USED

There is attached hereto a schedule showing the comparatives used for the taxable years 1919 and 1920. You will note seven comparatives have been used for the year 1919. Of these comparatives, it would seem that four were formerly of the old Standard group. At least two of them have substantial allowances for depletion, whereas the appellant company is entitled to no depletion. At my request, the auditors in the case have ascertained the amount of discovery depletion allowed to the South Penn Oil Co. and the Prairie Oil & Gas Co. The amounts based on discovery value are \$282,045.21 and \$2,203,070.95, respectively. The balance of the depletion claim as shown by the comparative sheets is due to depletion on cost or March 1, 1913, value. You will note two of the comparatives for 1919, Nos. 4 and 5, are somewhat questionable comparatives. On the other hand, the use of the Prairie Oil & Gas Co. as a comparative seems to offset the effect of the low percentage of tax on the two companies mentioned. If the two comparatives having a low percentage were eliminated and, at the same time, the Prairie Oil & Gas Co. were eliminated, the taxpayer would be entitled to a greater refund than is shown by the proposed overassessment. A study of these comparatives would indicate that Nos. 1, 2, 3, and 4 are really the best comparatives. Upon the basis of these comparatives there would be a greater refund. It seems that the seventh comparative was added to the comparative sheet to meet the objections raised by the reviewer in the case, who thought that the proposed overassessment, based on the first six comparatives shown on the comparative sheet, was giving the taxpayer an unreasonably low rate of tax.

I have carefully gone over the case with two of the auditors who prepared the case. In that conference the average tax paid by a great many oil companies was surveyed. A summary of the tax paid by the various oil companies submitted to me convinces me that the comparative sheets are reasonable and are the best that can be obtained under the circumstances.

GENERAL OBSERVATIONS

The claims for refund in this case were filed on the 9th day of March, 1927. This seems to have been the date on which the taxpayer first discovered that it was entitled to claim special assessment. The record, therefore, in this case substantiates the thought you have frequently had of late that a great many companies securing refunds due to special assessment were entirely satisfied as to the tax liability for a long period of years after the payment of the tax and only claimed special assessment after some one probably advised the taxpayer that, under present practice, a substantial refund might be obtained.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 17(A)

IN RE STANDARD OIL CO. OF KENTUCKY

TREASURY DEPARTMENT,
Washington, June 11, 1929.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
 Joint Committee on Internal Revenue Taxation,
 House Office Building, Washington, D. C.*

DEAR MR. PARKER: Reference is made to the certificates of over-assessment in favor of the above-named company for the years 1919 to 1921, inclusive, particularly in connection with the memorandum addressed to you by Mr. Chesteen under date of September 11, 1928, in regard thereto.

It is noted that Mr. Chesteen states that comparative No. 7 on the data sheet was added to raise the average rate of profits tax therein reflected. You are advised that it is not the bureau practice in general nor in the instant case to utilize or reject comparative companies in order to raise or lower the rate of tax. The selection of comparative concerns is governed by their representative characteristics alone and this was the consideration which led to the use of the comparative No. 7 in the preparation of the data sheet in the instant case.

The fact that a claim for special assessment is not made promptly does not, it is believed, affect the merits.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 18

IN RE THE PRUDENTIAL INSURANCE CO. OF AMERICA, NEWARK, N. J.

OFFICE OF THE GENERAL COUNSEL
 OF INTERNAL REVENUE,
August 28, 1928.

Mr. COMMISSIONER: Certificates of overassessment of corporation income tax in the amounts of \$760,355.76 and \$742,863.26 for the years 1925 and 1926, respectively, have been submitted for review in the case of the taxpayer named above. The allowances are to be made under the provisions of section 284 (b) of the revenue act of 1926 and are protected by claims for refund duly filed on June 14, 1928.

The claims are based on the decision of the United States Supreme Court in the case of National Life Insurance Co. v. United States (274 U. S. 734), decided June 4, 1928. In that opinion the Supreme Court held that section 245 (a) (2) of the revenue act of 1921 was unconstitutional in so far as it undertook to abate the deduction of 4 per cent of the mean of the reserve funds required by law and held during the year by the amount of interest exempt from taxation derived from State and Federal bonds, which exempt interest is allowed as a deduction under section 245 (a) (1). The provisions of the revenue acts

of 1924 and 1926 are the same as the provisions of the 1921 act, in so far as involved in the court decision. The bureau has, therefore, applied the decision to the instant case for the years involved.

For the year 1925, 4 per cent of the mean of the reserve funds required by law and held during the year amounted to \$46,566,092.27. However, under the regulations in force at the time the return was filed, the deduction taken in the return was \$40,483,434.36, being the excess of the said 4 per cent of the mean of the reserve funds over the deduction under section 245 (a) (1) of \$6,082,657.91 representing the interest exempt from taxation. Accordingly, the application of the court decision to this case results in decreasing income previously reported by \$6,082,657.91. Tax at 12½ per cent is \$760,332.24. The additional overassessment of \$23.52 represents the interest assessed on the November, 1927, list, pursuant to an assessment of additional tax in the amount of \$233.67 under an office audit whereby income from rents was slightly increased. Since under the present audit the correct tax liability is less than the tax assessed on the original return, there is no liability on the taxpayer for interest to the Government.

For the year 1926, 4 per cent of the mean of the reserve funds for the taxable year amounted to \$53,485,533.08. The deduction taken in the return on this account was \$47,542,647.77 representing the excess of the said 4 per cent of the mean of the reserve funds over the exempt interest deducted in the amount of \$5,942,885.31. Accordingly, under the court decision the income previously reported is decreased \$5,942,885.31. Tax at 12½ per cent is \$742,860.66 and the balance of the overassessment, \$2.60, represents interest assessed on the October, 1927, list, pursuant to an office audit which resulted in an additional tax of \$72.03. The inclusion of this item in the overassessment is due to reasons similar to those outlined above for the year 1925.

In view of the foregoing, it is recommended that the overassessments indicated above be allowed.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved: August 29, 1928.

D. H. BLAIR,

Commissioner of Internal Revenue.

APPENDIX 18(A)

IN RE MARINE SECURITIES CO., BALTIMORE, MD.

TREASURY DEPARTMENT,

Washington, June 11, 1929.

MR. L. H. PARKER,

Chief, Division of Investigation,

Joint Committee on Internal Revenue Taxation,

House Office Building, Washington, D. C.

DEAR MR. PARKER: Reference is made to the report addressed to you under date of November 8, 1928, by Mr. Chesteen in regard to an overassessment prepared in favor of the above-named taxpayer.

You are advised that the determination of the Income Tax Unit that the statutory invested capital of the above-named company

could not be satisfactorily established was carefully reviewed by the office of the general counsel. The conclusion reached by the unit was sustained by such review. As a result of this finding the claim of the taxpayer for the allowance of special assessment was approved. The certificate of overassessment arising out of an audit under the special-assessment provision was recommended for approval by the office of the general counsel. The bureau action in this connection was not, therefore, predicated upon the recommendation of one individual.

With respect to the selection of comparative companies, section 328 of the revenue act of 1918 provides that concerns shall be used which are as nearly as may be similarly circumstanced to the taxpayer with respect to gross income, net income, profits per unit of business transacted, and all other relevant facts and circumstances. The act also provides that the comparative companies should be engaged in a like or similar business to that conducted by the taxpayer. In view of these provisions with respect to the selection of comparative concerns, the bureau in the instant case included in the data sheet the only concern which appeared to be fairly comparable with the taxpayer during the year under review. As with many data sheets, it would have been possible to place other corporations thereon but due to the size and the effect of the concern used by the bureau upon the average of the comparatives the inclusion of other companies could have no material effect on the tax liability.

Under the circumstances in the instant case, it is the opinion of the bureau that the use of the single comparative company for the year 1920 was proper.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 19

IN RE INTERNATIONAL MERCANTILE MARINE CO., NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
November 5, 1928.

MR. COMMISSIONER: Certificates of overassessment have been prepared in favor of the above-named taxpayer in the amounts of \$927,866.04 and \$301,449.87 for the years 1919 and 1920, respectively. The refund (or credit) involved is to be made in accordance with the provisions of section 284 of the revenue act of 1926.

The International Mercantile Marine Co. is a corporation organized under the laws of New Jersey, and its wholly-owned subsidiary, the Atlantic Transport Co. of West Virginia, is a corporation organized under the laws of West Virginia. The principal office of these companies is at No. 1 Broadway, New York, N. Y. Consolidated returns were filed for both the years 1919 and 1920.

The overassessments for these years are due entirely to allowing the taxpayer credits for taxes paid to foreign countries, upon income derived from foreign sources therein, in accordance with the provisions of section 238 (a) of the revenue act of 1918.

At the time of submitting its return for the year 1919 the taxpayer did not claim any credit for taxes paid to foreign countries upon income derived from foreign sources therein. The taxes so paid, which have been substantiated as required by the law and regulations, amount to \$3,934,364.98. There was assessed on the original return \$927,866.04. The correct tax liability without taking into consideration the credit due for taxes paid to foreign countries has been ascertained to be \$1,433,814.08. This increased liability is due to various adjustments made as the result of a field investigation and office audit. However, after applying the credit due for foreign taxes there remains no tax liability and an overassessment of \$927,866.04 results, representing the tax assessed on the original return.

For the year 1920 similar facts prevail. The credit for foreign taxes for this year amounted to \$2,891,050.56. The correct tax liability for this year without taking into consideration the credit due for taxes paid to foreign countries is \$536,861.45, which amount is entirely eliminated by applying the credit for foreign taxes and as \$301,449.87 was assessed on the original return, an overassessment of \$301,449.87 results.

The overassessments are to be applied as a credit to a deficiency due for the year 1918 in the amount of \$1,883,349.21, which deficiency has been agreed to by the taxpayer.

In view of the foregoing it is recommended that the overassessments be allowed.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved November 5, 1928.

(Signed) H. F. MIRES,
Acting Commissioner of Internal Revenue.

APPENDIX 20

IN RE INTERNATIONAL MERCANTILE MARINE CO., NEW YORK, N. Y.

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, January 16, 1929.

MR. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: I am attaching hereto a copy of an opinion prepared by the office of general counsel with respect to the above-named taxpayer, as a result of a conference which you and I had with Mr. Bartholow and Mr. Ludwig, representing the Government.

Objection was made to the refund in the above-named case on the grounds that the bureau, in a well-prepared opinion by the office of general counsel, declined to allow a credit for foreign taxes approximating several million dollars for the year 1918 and that, subsequent to that decision, the action of the bureau had been reversed merely upon a statement of Mr. Ludwig that the case was reconsidered and

it was not believed the Government could win the threatened suit. It was admitted by both Mr. Bartholow and Mr. Ludwig, in the conference referred to, that the file did not contain an opinion such that the joint committee could pass the refund without some unfavorable criticism, and, in conformity with an agreement reached at the conference, Mr. Ludwig has prepared the attached opinion in order that the joint committee's file on the case may be complete.

You will note this opinion takes the position that certain income taxes imposed by Great Britain upon corporations is not a tax assessed upon the stockholder but that the corporation retains the tax out of the profits available for distribution as the collector for the Crown of England. I personally am not inclined to disagree with this portion of the opinion of Mr. Ludwig.

The other portion of the decision deals with the question of whether or not section 238(a) of the revenue act of 1918 is broad enough to cover a tax paid by a foreign subsidiary. A very careful and extensive study of this question has been made by Mr. Ludwig. Personally, I am not inclined to agree with him. It might be possible that the courts would hold as he indicates, but it strikes me there is sufficient doubt to warrant the testing of such a principle, especially in view of the fact that a large amount of tax is involved in this case and the question is one susceptible of an easy presentation to court.

I am aware that the case has already been acted upon by the bureau and the tax refunded. These comments are submitted to you merely to complete the record on the case. I might add that the case was not finally released until Mr. Ludwig delivered to me this opinion. He called me over the phone and asked me if I knew of any other reason why the refund should not be made. I informed him that this question was the only one before the joint committee, and, while I personally did not recede from my first position on the matter, there was nothing else in the case, so far as I knew, that the joint committee desired to make comments on.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

IN RE INTERNATIONAL MERCANTILE MARINE CO., NEW YORK, N. Y.

Mr. CHESTEEN: In accordance with our telephonic conversation on the morning of Thursday, December 13, 1928, I am forwarding herewith a review of the British authorities relative to the tax paid by British limited companies to the Crown on its profits for the shareholders in connection with the above-named case.

The International Mercantile Marine Co., in 1917, received from its British subsidiaries dividends aggregating \$9,129,277.11. These dividends were reported in the return, and deduction made thereof for purposes of the war-income and excess-profits taxes, inasmuch as the companies paying the dividends received income from sources within the United States.

The taxpayer now claims that the correct amount of the dividends for such year was \$9,129,277.11 plus British taxes paid by the British subsidiaries in respect to such dividends amounting to \$3,004,663.69 plus domestic dividends amounting to \$4,506,581.50. It further claims that, for purposes of the war-income tax and the excess-profits

tax, the \$3,004,663.69 is deductible as a part of the dividends received and is also deductible as foreign taxes paid.

The dividends received in 1917 were returnable under section 10 of the revenue act of 1916, as amended by section 10 (a) of the revenue act of 1917, for purposes of the 2 per cent income tax imposed upon the net income of corporations.

By section 12 (a) "Fourth" of the revenue act of 1916, as amended by section 12 (a) "Fourth" of the revenue act of 1917, deduction may be taken from the gross income of corporations of "Taxes paid within the year imposed by the authority of * * * any foreign country, * * *."

Section 4 of the revenue act of 1917, in dealing with the additional 4 per cent income tax imposed by Title I thereof, known as the war-income tax, prescribes in part as follows:

The tax imposed by this section shall be computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the tax imposed by subdivision (a) of section 10 of such act of September 8, 1916, as amended by this act, except that for the purpose of the tax imposed by this section the income embraced in a return of a corporation * * * shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation, * * * which is taxable upon its net income as provided in this title.

Section 206 of the 1917 act prescribes, with reference to the excess-profits tax, in part as follows:

That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * (c) for the taxable year upon the same basis and in the same manner as provided in Title I of the act * * * approved September 8, 1916, as amended by this act, except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, * * * subject to the tax imposed by Title I of such act of September 8, 1916, shall be deducted.

As disclosed by the quoted statutes, the various taxes are computed upon the same incomes and in the same manner, except that, (1) in determining the war income tax, there is a "credit" (deduction) of the amount received as dividends or from the net earnings of any other corporation taxable upon its net income with war income tax, and (2) in determining the excess-profits tax there is a like deduction where such other corporation was subject to the income tax.

The unit included in taxpayer's gross income, and the taxpayer agrees thereto, the British taxes of \$3,004,663.69 as though they were a part of the dividends, and consideration is first addressed to this phase of the case, namely, whether such taxes may properly be treated either as a part of "the amount received as dividends" or as an "amount received * * * from the net earnings of any other corporation." In *Pitney v. Duffy* (C. D.) 291 Fed. 621) the normal tax of 2 per cent, paid by a debtor corporation on its tax-free covenant bonds under section 1205 of the revenue act of 1917 and under section 221 (b) of the revenue act of 1918, was held not a part of the income of the bondholder, and hence not required to be included in his return, the court declining to follow a contrary ruling made in *Massey v. Lederer* (D. C.) 277 Fed. 123). The judgment was affirmed in *Duffy v. Pitney* (C. C. A.) 3d Cir.) 2 Fed. (2d) 230, and certiorari denied in 267 U. S. 595. In *Boston & Maine Railroad v. U. S.* (D. C.) 23 Fed. (2d) 345) the lessee agreed to pay "all taxes of every description, Federal, State, and municipal, upon the lessor's property, business, indebtedness, income, franchises, or capital stock,

or said rental." In 1917 the lessor was assessed income, war-profits, and excess-profits taxes, which were paid by the lessee. The commissioner included these taxes in the gross income of the lessor, but the court held that "The conclusive answer to the Government's contention, however, seems to be that there is no gain to the Fitchburg Railroad (the lessor) from the transaction," citing *Goodrich v. Edwards* (255 U. S. 527), *Pitney v. Duffy*, and *Duffy v. Pitney*, *supra*. Before the decision of the district court in *Pitney v. Duffy* Congress wrote into the revenue act of 1921 a provision touching income paid under tax-free covenants by which it prescribed that no deduction was allowable of the taxes so paid and no inclusion thereof was to be made in the gross income of the obligee. (Sec. 234 (a) (3).)

In the case of the present taxpayer the dividends declared were paid tax-free by the British subsidiaries with the exception of the dividend paid on the preferred shares of the Frederick Leyland Co. (Ltd.), where the tax was deducted from the dividend. The cases cited in the last preceding paragraph deal with taxes paid pursuant to contract, whereas here there was, as understood, no contract, but a voluntary tax payment by the subsidiaries out of earnings not declared as dividends (except on the preferred shares, as already indicated). Whilst as between the corporation and the sovereign the tax payment is not voluntary, yet as between itself and the shareholder deduction or no deduction is a matter of its own choosing, and it is in that sense that the word "voluntary" is used herein. Whatever distinction, in principle, obtains between the rulings made in the cited cases and the question here presented, is one militating more strongly here against adding the tax to the gross income of the taxpayer, for a tax payment made voluntarily on behalf of another is a very different thing from one made in virtue of a contractual obligation. In the latter case a right has been bought for a consideration, and it is well arguable that it is immaterial from an economic standpoint whether the tax be paid directly to the taxing authorities or in lieu thereof an amount equal thereto be paid to the shareholder. A different situation is encountered where the tax is deducted from, and thus paid out of, the dividend. The shareholder, upon the declaration of a dividend, becomes a creditor of the corporation to the extent of his proportionate part thereof, and any tax paid out of such part is paid out of what belongs to the shareholder. In other words, the shareholder's right as between himself and the corporation is to the whole, subject to the claim of the taxing sovereign, which through the corporation may then step in and exact a part. As said in one of the English cases (*Brooke v. Commissioners of Inland Revenue* (1918), 1 K. B. 257 (Court of Appeal)):

It seems to me * * * that it makes no difference for this purpose whether the income tax is deducted at the source under the operation of what Lord Halsbury calls, in *Ashton Gas Co.* against Attorney General, the "somewhat difficult and complex machinery which makes the officers of the company officers of the financial department of the Government for the purpose of collecting the tax," or whether the tax is directly assessed upon the person in question. The appellant here pays income tax although the tax is deducted at the source, * * *.

The conclusion reached, in the light of the foregoing, is that the British taxes in respect to the dividends which were paid tax-free are not includable in taxpayer's gross income.

The next subject of inquiry is whether the British taxes are deductible as "taxes paid within the year imposed by authority of * * * any foreign country, * * *." (Sec. 12 (a) "Fourth," supra.) That is, whether these taxes were imposed upon *this* taxpayer. The answer to this remits us, of course, to the British law.

In *Ashton Gas Company v. Attorney General* ((1906) A. C. 10), the House of Lords held, that where the company paid dividends in full without deduction of income tax there was a violation of the special act by which the company's profits to be divided among its shareholders in any year should not exceed 10 per cent, the basis of the ruling being that the shareholders had really received the 10 per cent and the tax as well. In *Mylam v. Market Harborough Advertiser Company* (1905) 1 K. B. 708, the company claimed exemption from income tax on the ground that its total income did not exceed £160. Its gross profits were £280, and from this amount £100 were paid as a dividend, and £90 were deducted for depreciation and expenses. The exempting statute excepted—

so much of such duties as the person claiming such exemption shall or may be entitled to charge against any other person, or to deduct or retain from or out of any payment to which claimant may be or become liable * * *.

It was held that, in view of the exception, the claim of exemption was unfounded; the court saying:

In the present case the company was bound to make the statutory return of its profits before payment of any dividend, and in paying the dividends they were entitled to deduct from the dividend of each shareholder the proper quota or proportion of income tax chargeable to him. I think, therefore, that there is no ground for holding that this company is entitled to exemption, * * *. The company loses nothing by this decision or by paying the income tax, because it deducts the amount of the income tax from the dividends before paying them to the shareholder; and equally the shareholders lose nothing because, if any shareholder is entitled to exemption, there is a well-known procedure by which he can obtain repayment of the amount of income tax deducted.

In *Purdie v. The King* (1914), 3 K. B. 112, a married woman was the owner of shares of an English company, and income tax was deducted by the company from the dividends. There was a statute providing that the profits of any married woman should be deemed the profits of her husband. The holding was that the tax was not charged upon the married woman but was charged upon the company. In the course of the opinion it said that—

Schedule D charges income tax upon the profits of the company made on behalf of its shareholders; and section 54 of the income tax act, 1842, provides that every company shall deliver a true statement of its annual profits before any dividend has been made to any persons and that such persons shall allow out of the dividends a proportionate deduction in respect of the duty charged. The company, therefore, is assessed and pays the tax. There is, strictly speaking, no tax upon the dividends at all; the company has to pay income tax upon its profits as a company, and, having paid the income tax, the effect is that there is less to divide among the shareholders. Sometimes a company declares what it calls a dividend "free of income tax," which means that having paid income tax the dividend paid is less because there is less to divide.

Sometimes it declares a dividend which it does not call free of income tax, and then it deducts a certain percentage from the dividend, stating that it is for income tax. The real effect of the latter course is, not that the company has declared a dividend of the full amount and then deducted income tax from it, but that it has declared a dividend of the net amount and told the shareholders that it would have been so much more but for the fact that the profits of the company were charged with the income tax before the dividend was made. Strictly speaking, therefore, the suppliant has not been charged with income tax at all in respect to her * * * dividends.

This ruling was questioned by Scrutton, L. J., in *Brooke v. Commissioners of Inland Revenue* ((1918) 1 K. B. 257 (Court of Appeal)) where he said:

I quite appreciate that there may arise in future cases difficult questions as to the exact position of a company and its shareholders. I am not at present satisfied that the reasoning in *Purdie v. Rex* (3 K. B. 112) is consistent with * * * *Ashton Gas Co. v. Attorney General* (1906) (A. C. 10); but it is not necessary, in my view of this case, to decide that point because I am quite clear that the company in paying income tax at the source at any rate pays as agent of the shareholders.

In the *Brooke* case the tax on all the income received by the taxpayer had been deducted at the source, and it was said by Warrington, L. J., that—

the appellant here pays income tax although the tax is deducted at the source, and in my opinion she is liable to pay supertax also.

Johnston v. Chestergate Hat Manufacturing Co. ((1915) 2 Ch. 338), arose out of an agreement between the company and its manager whereby he was to receive in addition to a salary a percentage of the net profits. Held, in determining the net profits, that the income tax was not first to be taken out; it being said:

But for the purpose of considering the strict way any such burden falls, it seems to me that any sum which is paid by the company on behalf of the shareholders of that company by way of income tax, under the system under which income tax is deducted at the source, is part of the net profits of the company available for dividends.

In *re Condran* ((1917) 1 Ch. 639) was a similar case but from the standpoint of the excess-profits duty. Held:

Income tax is ultimately payable by the person who is entitled to receive the profits. A company pays income tax on behalf of the shareholders and the income tax payable on his dividend is treated as part of his dividend, so that if he is in fact entitled to exemption he can recover the amount of the tax from the revenue authorities. * * * Excess-profits duty on the other hand is assessed on the person owning or carrying on the business, * * * and is payable in respect of the profits of the business, and not in respect of the benefit which a shareholder * * * derives from the business; and it is impossible for any shareholder * * * to claim a return of any portion of the duty on the ground that his total income is such as to entitle him to exemption.

See also *Collins v. Sedgwick* ((1916) 1 Ch. 179) and *Patent Castings Syndicate* ((1919) 2 Ch. 254) where said:

* * * Unlike income, tax they (the shareholders) do not themselves directly pay, or become liable to pay, any part of the excess-profits duty.

In *Samuel v. Commissioners of Inland Revenue* ((1918) 2 K. B. 553) the plaintiff held preference and ordinary shares, and the dividends upon the former were paid "less income tax," but, by resolution of the directors, the dividend on the ordinary shares was paid "free from income tax." In arriving at plaintiff's supertax, the commissioners added to the amount of the dividends actually received free of tax the tax so paid. This was held proper. (The plaintiff conceded that the gross dividends on the preference shares, i.e., the amounts prior to the deduction of the income tax thereon, were correctly included in the computation of the supertax.

When—
said the court—

a company has paid, for the sake of argument, a sum of £100 to a shareholder as dividend free of tax, it has also paid, assuming the rate of income tax to be

1s. 2d. in the pound, a further sum of £6 3s. 10d. to the Government. As far as the shareholder is concerned his share is really £106 3s. 10d., and the company pays £100 to him and £6 3s. 10d. to the Government as his agent and on his behalf. (Citing the Brooke case, *supra*.) For these reasons I think that the amount returnable for supertax purposes in the case of dividends paid free of income tax is not the amount actually received, but that amount plus the income tax in respect to it, * * *.

Commissioner of Inland Revenue *v.* Blott, et al. ((1921) 2 A. C. 171) was a House of Lords' decision holding a stock dividend not subject to the supertax (on grounds somewhat the same as those in *Eisner v. Macomber* (252 U. S. 189). Viscount Haldane said (p. 182):

Such a company is a corporate entity separate from its shareholders, * * *. He (the shareholder) can not sue for such a dividend until he has been given a special title by its declaration. Until then, do doubt, the profits are profits in the hands of the company until it has properly disposed to them, and it is assessable for income tax in respect to these profits.

Viscount Cave said (p. 201):

Some time was occupied in the discussion of the question whether in paying income tax on its profits the company acted as agent for its shareholders, and some cases were cited where this expression had been used. Probably the word was intended only to express in an abbreviated form the effect of section 54 of the income tax act, 1842. Plainly, a company paying income tax on its profits does not pay it as agent for its shareholders. It pays as a taxpayer, and if no dividend is declared the shareholders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate part of the amount of the tax previously paid by the company; and in that case the payment by the company operates in relief of the shareholder. But no agency, properly so called, is involved.

The following is from the opinion of Lord Phillimore in *Bradbury v. English Sewing Cotton Co.* ((1923), A. C. 774 (House of Lords)):

If the principle of its (the corporation) being a distinct person, distinct from its shareholders or the aggregate of its shareholders, had been carried to a logical conclusion, there would have been no reason why each shareholder should not, in his turn, have to return as part of his profits or gains under Schedule D the money received by him as dividends. Their taxation would seem to be logical but it would be destructive of joint-stock company enterprise, so the act of 1842 has apparently proceeded on the idea that for revenue purposes, a joint-stock company should be treated as a large partnership, so that the payment of income tax by a company would discharge the quasi-partners. The reason for their discharge may be the avoidance of double taxation, or to speak accurately, the avoidance of increased taxation. But the law is not founded upon the introduction of some equitable principle as modifying the statute; it is founded upon the provisions of the statute itself; and the statute carries the analogy of a partnership further, for it contemplates a company declaring a dividend on the gross gains, and then on the face of the dividend warrant making a proportionate deduction in respect of the duty, so that the shareholder whose total income is so small that he is exempt from income tax or pays at a lower rate, can get the income tax which has been deducted on the dividend warrant returned to him.

In *Ritson v. Phillips* (131 L. T. 384 (1924), K. B.) it is said:

Here is the old fallacy. He (the shareholder from whose dividends the tax had been deducted) is not taxed on his dividends. The companies are taxed on their profits, not as agent (as has been loosely said), though at his ultimate expense. There is no provision for the return of any of this tax to the shareholder save in the process of giving effect to deductions and reliefs.

The British income tax is assessed against the corporation on its net income and not upon its dividends. Where dividends are declared the corporation may recoup by deducting the tax or it may pay the dividends tax free. In either case, under the British law, the shareholder is evidently regarded as the real taxpayer. The cor-

poration does not pay the tax as agent of the shareholders, but, it would seem (see *Brooke v. Commissioners of Inland Revenue*, p. 3 hereof), as a collector for the Crown. See *Complete Practical Income Tax*, by A. G. McBain (third edition, 1927), pages 21 to 23, inclusive; *Dictionary of Income Tax and Super Tax Practice*, by W. E. Snelling (seventh edition), pages 236 and 267; *The Law of Income Tax*, by E. M. Konstam, K. C. (third edition), page 4.

The final question is one not of British law but concerns the construction of our own statutes.

There are here involved three Federal taxes, viz: (1) Income tax, (2) war income tax, and (3) excess-profits tax. The dividends are a part of the gross income for the purpose of each of these. But, as to the second and third tax, the dividends go out bodily by way of deduction. Hence, as to those taxes, the situation is the same as had no dividends whatever been received by the taxpayer. But that is not the end of the matter, for the taxpayer contends that, in the determination of each of these three taxes, it is entitled to deduct the British taxes (\$3,004,663.69) paid in respect of the dividends received by it from its British subsidiaries.

There is first of all the rule of strict construction of taxing statutes, but the rule is not inflexible. Adjudicated cases illustrative of the exceptions are not particularly helpful inasmuch as the question whether there should be, in a given case, an exception depends upon the situations presented in the case itself. The following cases are, therefore, to be regarded merely as showing that the courts will sometimes disregard the letter of a taxing statute.

Baltzell v. Casey (D. C., 1 Fed. (2d) 29) holds that a life beneficiary of a trust estate is taxable on the income actually paid over to him, without credit for his proportionate share of capital losses. Section 219 of the revenue act of 1918 prescribed that "there shall be included in computing the net income of each beneficiary his distributive share * * * of the *net income of the * * * trust* * * *." (Italics added.) Notwithstanding the presence in the statute of the italicized language, the court held:

There is no good reason why the beneficiaries should profit on their income taxes because of losses of principal with which, except as reflected in income, they are not concerned. The construction put upon the statute was that "distributive share" means distributive under the trust, and that the beneficiary's "distributive share of the net income of the estate or trust," on which he is to be taxed, is what he is entitled to receive under the terms of the will or instrument of trust, and not the sum which is regarded as income under the statute for very different purposes.

Affirmed in *Baltzell v. Mitchell* (3 Fed. (2d) 428), where it is said:

The construction of a statute must be a rational and sensible one, having in mind its evident purpose and the intention of Congress, and if such a construction can be found it must prevail, even though in conflict with the dry words of the statute.

The further reasoning of the court was along the lines of that of the court below.

In *Union Pac. R. Co. v. Bowers* (C. C. A., 24 Fed., 2d) 788, the taxpayer voluntarily filed an amended return showing more taxable income which it paid. The statute (sec. 250 (b) of the 1921 act) prescribed that "as soon as practicable after the return is filed, the commissioner shall examine it. If it *then* appears that the correct amount of the tax is greater or less than that shown in the return, the

installments shall be recomputed. * * * If the amount *already paid* is less than that which should have been paid" interest shall be paid on the deficiency from the due date. (*Italics added*). It was interest paid upon the tax shown on the amended return that the plaintiff sought to recover. Quoting from the opinion:

"The plaintiff contends that the statute only contemplates interest upon a deficiency * * * which existed at the time of the examination and audit of the returns * * * and says that at the time of such examination the tax had been paid in full, so that there was no deficiency, and could, therefore, be no interest due. * * * (But) an interpretation of the section (is not) reasonable which would enable a taxpayer, the incorrectness of whose return is first disclosed to him by a Government inspection, to pay his deficiency at the eleventh hour and thus deprive the Government of interest, by coming out ahead in a race with the commissioner." One of the judges dissented, saying, "But I find great difficulty in bringing the interest assessment within the language of their (the legislators') enactment. Tax laws are to be strictly construed, and what is not expressed is not included. * * * It is said that the construction for which I have argued leaves the question of interest dependent upon a race between the commissioner and taxpayer as to who shall first discover the mistake in the original return. This is true and perhaps indefensible as a policy of legislation, * * * But the question is not one of legislative policy, but of statutory construction."

In *Reid v. Rafferty*, (D. C., 4 Fed., 2d, 749), the taxpayer was a member of two partnerships each of which paid excess-profits taxes. In his individual return for 1917 the taxpayer deducted his proportionate share of such taxes. The statute prescribed:

That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess-profits tax imposed by act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and, in the case of a member of a partnership, with his proportionate share of such excess-profits tax imposed upon the partnership.

The following is from the opinion:

It does not seem to the court that Congress intended to allow an individual a double credit, if his income was derived in part from a copartnership, while to another, whose income arose from his own business, only one credit was permitted. If Congress had intended such an extraordinary and what would seem, indeed, a most unreasonable and unfair double credit, language would have been employed which could admit of no other meaning, such, for instance, as adding to the section, "notwithstanding the fact that credit therefor has already been allowed in the excess-profits return of the copartnership."

That was how one court looked at the matter, but the Circuit Court of Appeals did not so regard it (*Reid v. Rafferty*, 15 Fed. (2d) 264), saying in part:

The point seems to be without precedent, but to us it is plain that under the act of 1916 there were certain deductions or credits to which the individual taxpayer was entitled in respect of income derived from a partnership before stating his taxable income. Then came the excess-profits tax, which in effect diminished his partnership income, and contemporaneously with the laying of this burden the Congress permitted the partner to credit or deduct from his taxable income the excess-profits tax. It is quite useless to speculate on legislative motives, but it may be permissible to observe that, considering the size of the new tax of 1917, some reason appears for lessening the existing burden of income tax. But it is enough for us that we are persuaded that the letter of the law is plainly in favor of plaintiff in error.

If the British taxes are treated as having been paid by this taxpayer and are hence comprehended within the authorized deduction of "Taxes paid within the year imposed by the authority of * * * any foreign country, * * *" (sec. 12 (a) "fourth" of the revenue act of 1917), then they are admittedly deductible from the Federal

income tax. By the express provisions of the Federal statute (secs. 4 and 206 of the revenue act of 1917), see pages 1 and 2 hereof, the war income tax and the excess profits tax are to be "computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the" Federal income tax. In view of this unambiguous declaration of the congressional intent, it is not believed that the courts would disregard it merely because of the absurdity of recognizing the right to deduct both the *dividends* and the *British taxes* in determining the war-income tax and the excess-profits tax.

H. W. LUDWIG.

APPENDIX 20(A)

TREASURY DEPARTMENT,
Washington.

MR. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

DEAR MR. PARKER: In your report to the Joint Committee on Internal Revenue Taxation, reference is made under "Case No. 4—November" to the case of the International Mercantile Marine (hereinafter called the taxpayer) in which an overassessment of \$927,866.04 for 1919 and an overassessment of \$301,449.87 for 1920 have been allowed and credited against a deficiency due for the year 1918.

The aspect of the case referred to in the report involves the proper application of section 238 (a) of the revenue act of 1918, which so far as material provides:

That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.

The following extract from the report shows the pertinent facts in the case as well as the application the Treasury has given to section 238 (a) under those facts, with which application you state that you are not in agreement:

During the year 1919, the International Mercantile Marine Co. has income from sources within the United States. The correct tax liability on this income has been computed by the bureau at \$1,433,814.08. This company received during the year 1919, some millions of dollars in dividends from foreign corporations (British) of which it owned nearly 100 per cent of the stock. These dividends were not taxable in the United States under section 234 (a) (6), being "amounts received as dividends from a corporation which is taxable under this title upon its net income" and which amounts are deductions from net income.

Now the tax deducted at the source in Great Britain was \$3,934,364.98. This entire amount is allowed by the bureau as a credit against the United States income tax under their interpretation of section 238 (a). The result of this is to entirely wipe out the tax of \$1,483,814.08 which would have been due on income from sources within the United States. (Italics supplied.)

A tax deducted at the source is in legal effect a tax paid by the person from whose income the tax is deducted. The British taxes in question were deducted at the source by certain British corporations on account of dividends paid by those corporations to the taxpayer.

They were therefore income taxes paid to a foreign country by a domestic corporation upon income derived from foreign sources and accordingly fall clearly within the purview of section 238(a) of the revenue act of 1918. It is to be noted that that section allows a credit for income taxes paid to a foreign country "upon income from sources therein" and does not restrict the amount, as the later acts in effect do and as Congress might fairly have done by limiting the credit to income taxes paid to a foreign country upon income from sources therein "which is taxable in the United States under the existing revenue act."

The correctness of the conclusion the Treasury has reached as to the application of section 238(a) of the 1918 act becomes apparent from a more detailed statement of the situation and of the position of the department.

The pertinent question is, may British income taxes paid (collected) by a British corporation (the stock of which is owned by a domestic corporate taxpayer) which taxes are deducted by the British corporation from the dividends paid to a domestic corporate stockholder, be taken by the domestic corporation as a credit against the tax due the United States for 1918 and 1919 under the provisions of section 238(a), which provides that in the case of a domestic corporation the total income and profits taxes imposed for the taxable year "shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein?"

The British cases by the weight of authority sustain the proposition that British income taxes paid by a British corporation which are deducted by the corporation from the dividends paid its stockholders are actually taxes against the stockholders rather than against the corporation itself. The department has accepted this proposition. (S. M. 3040, C. B. IV-1, 198; S. M. 5363, C. B. V-1, 89.) The British courts have analyzed such taxes in various decisions as follows: "Income tax is ultimately payable by the person who is entitled to receive the profits. A company pays income tax on behalf of the shareholders, and the income tax payable on his dividend is treated as part of his dividend, so that if he is in fact entitled to exemption, he can recover the amount of the tax from the revenue authorities." (In *re Condran* (1917), 1 ch. 639.) "I think that the amount returnable (by a stockholder of a British corporation) for supertax purposes in the case of dividends paid free of income tax is not the amount actually received, but that amount plus the income tax in respect to it." (Samuel *v.* Commissioners of Inland Revenue (1918), 2 K. B. 553.) "* * * the statute carries the analogy of a partnership further, for it contemplates a company declaring a dividend on the gross gains, and then on the face of the dividend warrant making a proportionate deduction in respect of the duty, so that the shareholder whose total income is so small that he is exempt from income tax or pays at a lower rate, can get the income tax which has been deducted on the dividend warrant returned to him." In accord with the cited cases, see S. M. 3040 the syllabus of which reads:

"Where under the income tax act, 1918, of Great Britain, a tax is paid to the British Government by a British corporation on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United States under section 222 of the revenue acts of 1918 and 1921."

Also S. M. 5363, the pertinent portion of the syllabus of which reads as follows:

The tax deducted (by a British corporation) from profits distributed as dividends is a tax against the shareholder. The tax deducted from interest payments or annual charges is a tax against the recipient of the interest or other annual payments. The tax on the profits which are retained by the corporation is a tax against the corporation. The entire corporation profits tax is a tax against the corporation.

The recognized rule is, therefore, that British income taxes deducted from profits distributed as dividends by a British corporation are taxes against the stockholders, and that in legal effect the dividends received by the stockholders are equal to the amounts actually received plus the taxes collected at the source by the British corporation, and that such taxes are, in contemplation of law, paid by the stockholders and are not taxes paid by the corporation. Distinguished from such income taxes are the British excess-profits taxes which are actually imposed on, and paid by, the corporation in its own right.

With the above rule in mind, there can be little doubt as to the applicability to the taxpayer in the instant case of section 238 (a) of the revenue act of 1918. The British income taxes deducted from profits distributed as dividends to the taxpayer in 1918 and 1919 as the stockholder of a British corporation were taxes against the stockholder, and in legal effect such taxes were paid by the taxpayer upon income derived from British sources. Such taxes are accordingly properly allowable as a credit to the taxpayer against United States income tax under section 238 (a) of the 1918 act.

It has been suggested that section 238 (a) should be held to be inapplicable since the provisions of section 240 (c) of the 1918 act seem to be applicable. But the provisions of the latter section are not logically applicable. Section 240 (c) provides:

For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits, and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under sec. 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided*, That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under sec. 234) received by such domestic corporation during the taxable year.

A reading of section 240 (c) indicates that its purpose was to give a domestic corporation the benefit of a limited credit for certain taxes *paid by a foreign subsidiary corporation* in addition to the credit allowed by section 238 (a) for foreign income and profits taxes *paid by the domestic corporation*. Note the language of the section "a domestic corporation * * * shall be deemed to have paid." Such phraseology is entirely inappropriate to taxes which were in legal contemplation paid by the domestic corporation. Section 240 (c), therefore, has no application to the taxes involved in the instant case which in contemplation of law were actually paid by the taxpayer (and are therefore properly taken as a credit under section 238 (a)) and were not in contemplation of law paid by a foreign

subsidiary corporation. The taxes referred to by section 240 (c) must be taken to be the taxes which are imposed directly against a foreign subsidiary corporation, such as the British excess-profits tax imposed on British corporations. As to such taxes section 240 (c) is undoubtedly applicable, but the section can have no application to taxes merely collected at the source by a foreign corporation and in contemplation of law imposed upon and paid by a domestic corporation.

For the reasons stated it is believed that the allowance of the overassessments for 1919 and 1920 in the case of the International Mercantile Marine Co. was entirely in accordance with law.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 21

IN RE MIDDLE STATES OIL CORPORATION, NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
October 24, 1928.

MR. COMMISSIONER: In the case of the taxpayer named above, certificates of overassessment of corporation income and profits taxes have been submitted for review for the years 1918, 1919, and 1920, in the amounts of \$115,568.67, \$696,060.90, and \$3,771,597.20, respectively.

The overassessments abate additional taxes assessed in 1924 as follows: 1918, \$115,568.57 assessed in March, 1924; 1919, \$685,978.27 assessed in December, 1924; and 1920, \$3,613,258.73 assessed in December, 1924. These were jeopardy assessments made under the provisions of section 250 (d) of the revenue act of 1921 and section 274 (d) of the revenue act of 1924. The balance of the overassessments represents refunds of taxes assessed on the original returns and paid as follows: 1919, \$10,082.63, and 1920, \$158,338.47. The refunds are protected by claims duly filed under the provisions of section 284 (b) of the revenue act of 1926.

The overassessments are due to reversals of arbitrary disallowances made incident to the jeopardy assessments and to corrections of overstated income in the returns resulting from defective accounting records, inclusion of nontaxable income and income of corporations erroneously included in the consolidated group.

During 1918, taxpayer owned 100 per cent of the capital stock of the Number One Oil Co. During 1919, it owned 100 per cent of the capital stock of the Number One Oil Co. and the Number Seventy Seven Oil Co. It owned 69 per cent of the capital stock of the Ranger Texas Oil Co. and 52 per cent of the capital stock of the Dominion Oil Co. At December 31, 1920, it owned 77 per cent of the capital stock of the Dominion Oil Co. and 80 per cent of the capital stock of the Ranger Texas Oil Co. It owned 38 per cent of the capital stock of the Texas Chief Oil Co. at January 1, 1920 and 93 per cent at December 31, 1920. Due to incomplete records, it is impossible to tell when the increase in stock ownership took place. During 1920, taxpayer also owned a certain percentage of the capital stock of the Imperial Oil Co., but the records fail to indicate any definite figure.

The original 1919 return included in the consolidated group the Number One Oil Co., the Number Seventy-Seven Oil Co., the Ranger Texas Oil Co., and the Dominion Oil Co. The original return for 1920 included the Number One Oil Co., the Number Seventy Seven Oil Co., the Dominion Oil Co., the Ranger Texas Oil Co., the Texas Chief Oil Co., and the Imperial Oil Co.

In the present audit, the taxpayer has been ruled affiliated with the Number One Oil Co. in 1918 and 1919, and with the Number One Oil Co. and the Number Seventy Seven Oil Co. in 1919 and 1920. The Texas Chief Oil Co. has been excluded, inasmuch as there is no evidence that the taxpayer owned or controlled more than 38 per cent of the stock for any appreciable time during the year 1920. The Ranger Texas Oil Co. and the Dominion Oil Co. have been excluded since the taxpayer owned a maximum of but 77 per cent of the Dominion Oil Co. and 80 per cent of the Ranger Texas Oil Co. and there is no evidence of other control. The Imperial Oil Co. has been excluded inasmuch as there is no evidence of the extent of the stock ownership or control. Since the evidence with respect to the excluded companies fails to show either that taxpayer owned or controlled substantially all the stock or that substantially all the stock was owned or controlled by the same interests, the ruling appears proper. (Sec. 240 of the revenue act of 1918; article 633 of Regulations 45.)

The returns filed by the taxpayer for itself and subsidiaries were incomplete and unsatisfactory. The case was referred to the field for investigation. The revenue agent at New York could find no books or records to aid in verifying the returns and was informed that certain of the records at least had been sent out of the country to France to forestall subpœna in pending court actions. In this unsatisfactory state of affairs the revenue agent took reports made by the taxpayer to the New York Stock Exchange, and after disallowing certain items shown thereon as deductions from gross income reported the net results as the gross income for the years 1919 and 1920, as follows:

1919—Net income

Net income as disclosed by return.....	\$102, 826. 34
As corrected.....	1, 522, 610. 64
Net additions.....	1, 419, 784. 30
Additions:	
(a) Field operations and new construction.....	\$290, 744. 95
(b) Taxes including Federal and lease rentals.....	11, 870. 79
(c) Redemption of preferred stock.....	40, 220. 00
(d) Syndicate expenses.....	37, 500. 00
(e) Unaccounted difference in gross income.....	126, 607. 78
(f) Depletion reserve disallowed.....	695, 539. 86
(g) Depreciation reserve disallowed.....	217, 300. 92
Total additions.....	1, 419, 784. 30
Total deductions.....	None.
Net additions as above.....	1, 419, 784. 30

1920—Net income

Net income as disclosed by return.....	\$1, 279, 910. 36
As corrected.....	8, 208, 559. 13
Net additions.....	6, 928, 648. 77

Additions:

(a) Field operations and new construction..	\$1, 420, 752. 72
(b) Depletion deduction disallowed.....	3, 642, 495. 42
(c) Depreciation deduction disallowed.....	323, 208. 02
(d) Unaccounted difference in gross income..	1, 542, 192. 51

Total additions.....	\$6, 928, 648. 77
Total deductions.....	None.

Net additions as above.....	6, 928, 648. 77
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It is shown that the jeopardy assessments resulted from adding to income the unexplained difference between gross income per return and gross income per report to the stock exchange; also the disallowance of deductions for depletion, etc.

For 1918, the return showed no net income and was not filled out, but in a letter attached to the return the taxpayer mentioned the expenditures during the year of certain sums for named purposes. The revenue agent in the absence of a stock-exchange report for this year merely treated all the items mentioned in the letter as income.

Additional taxes assessed as shown above were based on the revenue agent's report without change except for a revision in the computation of the tax for 1918.

It was, of course, apparent that an exact determination had not been made and after taxpayer filed a protest in connection with its abatement claims, the case was assigned to travel auditors of the Income Tax Unit who spent over a month in checking and verifying the revised statistics submitted for the taxpayer by the accounting firms of Mattison & Davey and Ligon & Co. These firms had men in the field for months compiling the data on which the taxpayer's revised briefs were based and which formed the starting point of the investigation by the said travel auditors. The travel auditors submitted a complete report of a careful investigation. It appeared that in the course of the work done by the taxpayer's agents, records and books more or less detailed were brought to light, and against these records the travel auditors were enabled to check the taxpayer's revised brief and verify the same in greater part.

It appears that the income reported to the stock exchange as gross income from operations was overstated by income derived by the chairman of the board of directors of the Middle States Oil Corporation from dealing in stock of the parent and subsidiary corporations. The value of the stock on the stock exchange was influenced by this overstated income, by refinancing whereby the value of the leases held was appreciated and by the apparent activity of the stock caused by the chairman's operations. The quoted price was raised from around \$10 par to approximately \$70.

The difficulty in the audit of the case arose out of this stock speculation. It was not desired that the corporation's books should reflect this activity, consequently, the stock activities were carried on for the corporation by the chairman, Mr. C. N. Haskell, usually in the names of members of his family or employees of the corporation. The stock was bought and sold through numerous brokers. For a part of the time Mr. Haskell had a private cashbook in which his activities were recorded. Later a corporation, the Reliable Securities Co., was formed to act as agent in the stock operations. The proceeds from the sales of stock were received by Mr. Haskell from the brokers. He also received all remittances from the sales of oil. It appears

that the pipe-line corporations purchasing oil from the taxpayer's operating subsidiaries made payment to an agent in the field. These remittances were then forwarded by New York exchange to Mr. Haskell. From time to time, Mr. Haskell would deposit to the credit of the Middle States Oil Corporation varying sums usually designating the remittances as "oil settlements," or crediting the deposits to one or the other of the various subsidiaries.

It was recognized that the question of the oil sales was the paramount issue in the audit of the case. The records of all purchasers of oil from the field of taxpayer's operations were examined and records secured of the actual oil run and amounts paid therefor for each lease in which the corporations involved held interest. This information was checked against records of joint owners or lessees of the leases, and the production was checked against the gross production reports required to be filed with the State officials. Thus, the actual income from oil sales was established. The investigation then accounted for the discrepancy as follows: In 1919, the decrease in gross sales per books is \$964,324.01. Of this amount, \$728,467.75 represents sales of stock actually traced to books of brokerage houses; \$234,870 represents items which Mr. Haskell had designated in his records as oil settlements, etc., and yet which have no corroboration in the actual facts of production.

In 1920 the reduction in gross sales is \$1,395,254.59, and of this amount \$1,375,086.90 has been traced to the personal cashbook of C. N. Haskell. As he had no source of income except from oil remittances or stock dealings, it has been presumed that this represents gain or premium on sales of stock. The investigation disclosed that Mr. Haskell's dealings in stock were practically confined to the stock of the Middle States Oil Corporation. The exclusion of this income arising from purchasing or selling the corporation's own stock is in accordance with the department regulations. (Art. 542, Regulations 45.)

In the present audit of the case, the income shown by the revenue agent for the year 1919 has been decreased \$1,759,476.35. Income reported in the return as derived by the Dominion Oil Co. is excluded in the amount of \$284,050.65. Depreciation is allowed in the amount of \$51,665.04 and depletion in the amount of \$73,945.60. The present allowance represents depreciation and depletion on the cost of assets owned and the deductions have been found proper under the provisions of section 234 (a) (9) of the revenue act of 1918. The revenue agent disallowed deductions of \$290,744.95 for field operations and new construction. In the present audit \$210,504.04 is allowed for development and lifting expense. This item was charged to expense by the taxpayer on books and returns and the deduction from income is, therefore, proper under article 223, Regulations 45. As shown above, the gross sales are decreased \$964,324.01. Inasmuch as the present audit reconciles with the books, there is necessitated a reversal of the arbitrary increase of \$126,607.78 made by the revenue agent to account for the discrepancy between income returned and income shown in the stock-exchange report. Miscellaneous allowable expense items account for the remainder of the deduction. The revenue agent's disallowance of a deduction of \$40,220 for redemption of preferred stock related to income of the Dominion Oil Co. and has been considered in arriving at the tax liability of that company.

For the year 1920, the income shown by the revenue agent is decreased \$8,738,032.82. Income reported in the return as derived by the excluded subsidiaries has been eliminated as follows: Dominion Oil Co., \$1,619,378.50; Texas Chief Oil Co., \$2,066,329.87; and Imperial Oil Co., \$883,077.94. The amounts excluded are in greater part gross income, and the investigation discloses that after allocating to these companies their true expenses and after making proper deductions for depreciation and depletion, net operating losses are reflected for the Dominion Oil Co. and the Texas Chief Oil Co., and that net income of the Imperial Oil Co. is shown as \$89,734.68.

As shown above, the overstatement in gross sales of the Middle States Oil Corporation was \$1,395,254.59. Income reported by the agent has been decreased by this amount. Expenditures now allowed for development and lifting expenses amount to \$189,282.31, and deductions for depreciation and depletion are allowed in the amounts of \$146,422.32 and \$913,319.57, respectively. The taxpayer made a disastrous purchase of certain oil leases, and depletion at cost in connection with this investment accounts partially for the increase in the depletion allowance in this year. Other miscellaneous adjustments of a minor nature account for the balance of the decrease in income.

The revised audit discloses net losses of \$236,865.71 and \$529,473.69 for 1919 and 1920, respectively. Under the provisions of section 204 of the revenue act of 1918, the net loss for 1919 is credited against the net income for 1918 (\$152,185.29), and therefore there is no tax due for any of the three years involved.

In accordance with the foregoing, it is recommended that the over-assessments indicated above be allowed.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved: October 26, 1928.

(Signed) D. H. BLAIR,
Commissioner of Internal Revenue.

APPENDIX 22

IN RE MIDDLE STATES OIL CORPORATION, 170 BROADWAY,
NEW YORK CITY

NOVEMBER 19, 1928.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the above-named taxpayer's case for the calendar years 1919 and 1920, involving overassessments of \$696,060.90 and \$3,771,597.20, respectively.

The large overassessments in this case are due to the fact that the bureau made an assessment for these years based upon the report of the revenue agent from the New York office, this report being based on the report of the above named taxpayer to the New York Stock Exchange rather than upon the basis of the books and returns. Ex-

amination of the file indicates that a second report was made by the travel audit under date of April 12, 1927. This report has been somewhat carefully prepared and indicates every effort has been made to piece together a story from the remaining records of this company and from records of taxpayers doing business with it during the period under examination. As a result of this examination a net loss is disclosed for each of the years in question.

Review of the revenue agent's report indicates it is substantially correct in principle if the facts are as stated in the report. There is nothing much this committee can do to verify the references or statements made in this report other than to accept them as shown. In view of this situation, it is believed no criticism should be offered to the proposed refund in this case.

Respectfully,

(Signed)

G. D. CHESTEEN,
Corporation Auditor.

APPENDIX 23

IN RE OHIO OIL CO., AND MID-KANSAS OIL & GAS CO. (SUBSIDIARY),
FINDLAY, OHIO

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE.

MR. COMMISSIONER: Certificates of overassessment in favor of the above-named corporations have been prepared as follows:

Ohio Oil Co.:

1916.....	\$11,060.95
1917.....	664,286.92
1918.....	1,179,565.77
Mid-Kansas Oil & Gas Co., 1916.....	3,224.42

The above overassessments are principally due to adjusting depletion on oil and gas wells allowing depletion on the March 1, 1913, value, whereas the amount deducted on the returns was based on cost, to adjusting the depreciation allowance on oil and gas properties and to revising the inventories from market to cost basis.

The Ohio Oil Co. owned 99.87 per cent of the outstanding capital stock of the Mid-Kansas Oil & Gas Co., and the companies are therefore properly affiliated for the years 1917 and 1918 within the purview of sections 240 and 1331 of the revenue acts of 1918 and 1921.

For the calendar year 1916 the Ohio Oil Co. filed an income-tax return disclosing a net income of \$14,835,178.17 and a tax of \$296,703.56 was assessed on the basis of the return. In the present audit, the net income is found to be \$12,063,494, a decrease of \$2,771,684.17 from the return. The decrease consists of accrued 1916 local taxes, \$553,047.70, and additional depreciation and depletion allowable in the amount of \$3,228,617.19. The total of these two items allowed has been offset in part by items disallowed as deductions from income aggregating \$1,009,980.72. The items restored to income are interest receivable, \$2,066.68; inventory adjustments, \$193,952.38; oil and storage adjustments, \$378,039.69; local benefit taxes, \$781.62; and 1915 local taxes restored to income, \$435,140.35. The taxpayer's books are kept on the accrual basis and the taxes for 1916 in the amount of \$553,047.70 have been accrued and allowed as a deduction

in this year. The 1915 taxes, \$435,140.35, which were paid during 1916, are restored to taxable income. Interest due the corporation at the end of the taxable year and not previously reported as taxable income is now restored to income, \$2,066.68.

At the close of the year 1917, a physical inventory was taken of materials and supplies at the warehouses and other depots of all the producing divisions at which time it was found that the value of these physical inventories exceeded the value shown on the books by \$763,027.93. This situation was caused by the lax system employed in the receipt and distribution of materials and the poor records kept by the field men. At that time it was believed that the difference was due to the fact that more material had been charged to the Wells Farms than had actually been issued. Based upon this belief, an entry was made at the close of the year 1917 charging materials and supplies for \$763,027.93 and crediting Wells Farms for the same amount. It was not until 1920 that it was discovered that the Wells Farms had not been overcharged with materials and supplies issued during and prior to 1917, and therefore an entry was made at the close of 1920 reversing the 1917 entry. This left the charge still unadjusted and through an oversight no attempt was made to adjust the difference until the close of 1921 at which time it was realized that the overage was an item of income and an entry was made charging materials and supplies, \$763,027.93 and crediting profit and loss for the same amount. The amount of \$763,027.93 was included in the taxable income for the year 1921 but inasmuch as the overage existed in 1917 or preceding years it was taxable income for the year 1917 or the years prior thereto. Adjustment is therefore made as follows: \$193,952.38 of the overage is allocated to the year 1916 and \$569,075.55, the remainder, to the year 1917, increasing the income of those years respectively by these amounts.

The field examiners found it necessary to revise the inventories of storage oil from the market basis to a cost basis, cost being lower than market. This method of inventorying the storage oil has been consistently applied to all the years 1916 to 1922 inclusive. The inventories have been carefully examined by the Income Tax Unit and the changes in income necessary to properly reflect said changes in the inventories are believed to be properly established. The opening inventory for 1916 was thereby decreased by \$487,658.31 and the closing inventory was decreased by \$109,618.62, making a decreased cost of sales amounting to \$378,039.69 and this amount is restored to income.

The depletion allowance for the years 1916 to 1922, inclusive, is based upon an engineer's report of the oil and gas subsection of the bureau, dated May 5, 1928. The taxpayer and its subsidiary company have some three thousand five hundred and odd leases and fee properties. However, only the oil and gas have been valued. There are therefore no agricultural or real estate values included. The depletion for the years 1916 and 1917 is allowed on the March 1, 1913, value of \$39,432,496.95, as determined by the bureau engineers based upon analytical appraisals which have been checked by the barrel per day production method and sales. It has also been found that the reserves thus created in a good many instances check out very accurately with the actual production. In 1918 depletion has been allowed on discovery values as well as on March 1, 1913, values.

The drilling costs have been capitalized up to December 31, 1917, and for 1918 and subsequent years drilling costs have been charged to expense. This method of treating the drilling costs has finally been agreed upon by the taxpayer and the bureau after much consideration. As the result of the evidence submitted and conference held with the taxpayer's representatives, it was found that the taxpayer exercised an option to expense its drilling costs beginning with the year 1918 but that such option was not retroactive to prior years. The reasons for this conclusion are set forth fully in the memoranda of this office dated November 27, 1926 (G. C. M. 984), and December 12, 1927 (G. C. M. 2902), which are made a part of the file in the case.

Upon the basis above outlined a total depletion of \$5,195,969.36 has been allowed for the year 1916, and depreciation in the amount of \$1,723,713.64 has been allowed by the bureau engineers on oil and gas properties upon which no depletion was allowed, making a total allowance for depletion and depreciation of \$6,919,683. As the total depletion and depreciation deducted on the return was \$3,691,065.81, there is therefore a further deduction of \$3,228,517.19 now allowed.

On the basis of this corrected net income the correct tax liability is found to be \$241,269.88, producing an overassessment of \$55,433.68. However a part of this amount is barred by the statute of limitations, as no claim for refund has been filed. A computation of the refund or credit allowable under the provisions of section 284 (c) of the revenue act of 1926, made in accordance with G. C. M. 813, C. B. V-2-100, discloses that \$44,372.73 of this amount is barred by the statute of limitations and that the balance, \$11,060.95, is refundable.

The Mid-Kansas Oil & Gas Co. filed a return for the year 1916 disclosing a net income of \$171,615.49 and upon the basis of this return a tax of \$3,432.31 was assessed. The present audit discloses a net loss of \$5,393.29 due to allowing additional depletion and depreciation in the amount of \$161,221.24 and to allowing an inventory adjustment on account of storage oil in the amount of \$15,787.54. These two items were allowed on the same principle as discussed in connection with similar items of the Ohio Oil Co. Upon this basis there is no tax due from this company. However of the entire amount of tax assessed only \$3,224.42 is refundable under section 284 (c) of the revenue act of 1926, in accordance with a computation under G. C. M. 813, the taxpayer not having filed a claim covering this year.

For the year 1917 the taxpayer corporation and its subsidiary company filed separate income-tax returns in which the net income of the parent company was shown to be \$16,937,912.26 and the net income of the Mid-Kansas Co. \$69,162.20. The consolidated invested capital was computed at \$81,166,011.93 on the excess-profits tax return and a total tax of \$3,136,426.15 was assessed against the parent company, while \$7,291.48 was assessed against the Mid-Kansas Co. In the present audit the net income of the parent company is found to be \$15,197,743.90, a difference of \$1,740,168.36 from the return. The difference consists of allowing additional depletion of \$870,017.47, additional depreciation of \$1,758,661.88, adjustment on account of storage oil inventories, \$334,661.90 and 1916 interest restoration, \$2,066.68. The aggregate of these deductions has been offset in part by unallowable deductions restored to income amounting to \$1,225,239.57, consisting of inventory of material and supplies, \$569,075.55, explained in connection with the item \$193,-

952.38 restored to income for 1916; 1916 taxes restored to income for this year as previously explained, \$551,106.23; miscellaneous expense adjustment, \$42,159.23; and income restorations, amounting to \$62,898.56. Miscellaneous expense adjustment and income restorations have been verified by the various revenue agents and are found to be properly established. Depletion and depreciation are in accordance with the allowance made for the prior year as fully explained in connection with the said year. In 1916 there was restored \$2,066.68 to income and this amount is now allowed as a deduction from income in 1917. The adjustment on account of storage oil inventories \$334,661.90 is necessary in order to value these inventories consistently over the years under review. The adjustment consists of decreasing the closing inventory \$444,280.52 and decreasing the opening inventory, as explained in connection with this corresponding adjustment for 1916, \$109,618.62, making a decrease in net income of \$334,661.90. The net income disclosed by the return of the Mid-Kansas Co. is now increased to \$391,071.85, an increase of \$321,909.65 due to disallowing sundry deductions from income in the amount of \$5,118.04, making a depletion adjustment of \$543,777.52 and by adjusting the inventory in the amount of \$15,544.06 the aggregate of these restorations is offset in part by allowing additional depreciation in the amount of \$242,529.97. These adjustments are in accordance with the audit principles upon which the year 1916 has been audited, and the explanations of these items as made in connection with the adjustments of similar items of the Ohio Oil Co., apply here. The consolidated invested capital is now found to be \$86,039,295.40, an increase of \$4,873,283.47 from the return. The increase is due to restoring the following items: Accrued interest not allowed as a deduction from income in 1916, \$2,066.68; the inventory adjustment made in 1916, \$193,952.38; and the depreciation adjustment, amounting to \$6,632,747.34. The aggregate of these restorations has been offset in part by deducting the following items:

1916 county tax deducted from 1916 income.....	\$553, 047. 70
Depletion sustained on cost.....	960, 178. 11
Inventory adjustment, 1916.....	109, 618. 62
Depreciation subsidiary company.....	65, 273. 56
Depletion subsidiary company.....	95, 947. 68
Inventory subsidiary company.....	15, 787. 54
Adjustment on account 1916 income taxes.....	155, 629. 72

The restoration for excessive depreciation deductions in prior years is necessary in order to correct the books to properly reflect the surplus as of January 1, 1917, in accordance with the findings of the field examiner. All of the other items producing the change in invested capital are self-explanatory.

Upon the basis of this consolidated income and invested capital a total excess profits tax of \$1,702,601.90 has been computed, of which amount \$1,659,866.59 has been allocated to the Ohio Oil Co. and \$42,735.31 to Mid-Kansas Oil & Gas Co., the same being 97.49 and 2.51 per cent, respectively, of the consolidated net income, the allocation being based on the net income of the various companies. Upon this basis the correct tax liability of the parent company is \$2,472,139.23 producing an overassessment of \$664,286.92 allowable under the provisions of section 284 (c) and (h) of the revenue act of 1926, taxpayer having filed claim for refund within five years from

the date the return for the taxable year was due. The correct tax liability of the Mid-Kansas Oil & Gas Co. is \$63,635.50 producing a deficiency of \$56,344.08, which is being assessed. A valid consent which will expire on December 31, 1928, is on file in the bureau. There are also additional taxes due for the years 1919 to 1922, inclusive, which are covered by consents duly filed.

For the year 1918 the taxpayer and its subsidiary company filed a consolidated return disclosing a net income of \$16,852,790.13. The invested capital reported on this return was \$81,382,341.60 and a tax of \$4,915,419.60 was assessed on the basis of the return. In the present audit the corrected consolidated net income is found to be \$14,594,897.74, a decrease of \$2,257,892.34 from the return, consisting of allowing additional depletion, \$717,906.84, development costs charged to expense, \$2,278,663.84, and interest decreased, \$20,762.95, making an aggregate deduction of \$3,017,333.63. This total deduction, however, is offset in part by items disallowed as follows:

Inventory of storage oil beginning and end of year corrected.....	\$379, 505. 42
Depreciation decrease restored to income.....	220, 968. 31
Sales increase as computed by the revenue agent.....	58, 225. 61
Local tax adjustments as computed by the revenue agent.....	1, 292. 96
Donations restored, not allowable.....	86, 750. 00
Furniture and fixture adjustment.....	299. 08
Unreported items, computed by the revenue agent.....	12, 399. 86
Total.....	759, 441. 24

The additional depletion allowance is in accordance with the engineer's report, which is fully explained in connection with the adjustment for 1916. The development costs in the amount of \$2,278,663.84, which had been capitalized on the books, are now allowed as expense in accordance with the explanation previously made herein. The allowance on account of interest received is due to the fact that the amount reported in the return on account of this item was \$2,222,334.39, whereas the total amount reflected in the books was only \$2,212,581.44. The difference is therefore deducted from income. The items restored to income are largely self-explanatory or have been previously explained.

The consolidated invested capital reported on the return is now increased by \$6,323,631.35. The increase is due to the fact that the surplus account at the time of filing the return was understated by \$5,763,273.80. The consolidated surplus at January 1, 1918, as disclosed by the revenue agent's report was \$71,944,151.28, whereas only \$66,180,877.48 surplus was included in invested capital on the return. This increase includes \$2,993,046.57 realized appreciation. The surplus reserves at the beginning of the year have also been adjusted necessitating an increase to these accounts of \$1,722,510.77. The taxpayer's adjustments on the return on account of inadmissible assets was overstated by \$1,314,525.04 and this amount is now restored. The aggregate of these restorations has been offset in part by deductions from invested capital as follows: Elimination of purchase price of the capital stock and surplus of Mid-Kansas Oil & Gas Co. at date of acquisition, \$445,850.15; correct 1917 Federal tax prorated, \$1,389,465.61; and dividends paid during the year in excess of available earnings, \$641,362.50.

Upon the basis of this corrected consolidated net income and invested capital the correct income and profits tax is found to be \$3,735,853.83, producing an overassessment of \$1,179,565.77, allow-

able under the provisions of section 284 (c) and (h) of the revenue act of 1926, the taxpayer having filed claim for refund within five years from the date the return was due.

The adjustments for depreciation, inventory valuation of storage oil, and development costs allowed as expense in 1918 have been made by the various examining officers of the bureau, with the assistance of the engineering section. The restorations made to invested capital are necessary in order to properly reflect the changes made in the income for prior years.

All of the adjustments producing the overassessments for the years 1916, 1917, and 1918 are believed to be properly established.

It is accordingly recommended that the overassessments indicated herein be allowed.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved December 5, 1928.

(Signed) D. H. BLAIR,
Commissioner of Internal Revenue.

APPENDIX 24

JANUARY 10, 1929.

Mr. E. C. ALVORD,

*Special Assistant to the Secretary of the Treasury,
Washington, D. C.*

MY DEAR MR. ALVORD: From a preliminary examination, this office is not in complete agreement with the refund proposed in the case of the Ohio Oil Co. for the year 1918. The 30-day period in this case expires January 14, 1929.

The issue which we raise is in regard to changing the method of reporting drilling costs from the basis of capitalization to the basis of expense items.

This was specifically denied by Mr. Gregg in G. C. M. 984.

It was specifically denied by Mr. Hartson in a letter on the Standard Oil Co. of California dated July 9, 1923.

Mr. Charest's office reverses these decisions only on authority of T. D. No. 4025, dated June 18, 1927. It is our opinion that this Treasury decision is not retroactive in any respect to the years under discussion in the Ohio Oil Co. case. It relates solely to the 1926 act.

While the decision of Mr. Charest purports to be based also on new facts, these facts do not constitute evidence, as the general counsel's memorandum admits them to be based on an assumption. Note the quotation below from G. C. M. 2902:

Upon the assumption that these events actually happened, this office believes that a conclusion different from that in the opinion of November 27, 1926, must be arrived at.

This seems to be most extraordinary to the writer, that a point involving nearly \$1,000,000 in tax would be reversed against the Government on an assumption.

In view of the expiration of the 30-day period in this case on January 14, 1929, I would appreciate it if you would arrange a conference for me on this case at the earliest possible moment with your general counsel's office.

Very truly yours,

L. H. PARKER.

APPENDIX 24(A)

IN RE OHIO OIL CO., FINDLAY, OHIO

TREASURY DEPARTMENT,
Washington, June 11, 1929.

Mr. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.

DEAR MR. PARKER: There is transmitted herewith a copy of a memorandum prepared by the office of the general counsel of internal revenue with reference to the overassessments proposed in favor of the above-named company.

It is believed that this consideration of the questions raised by you presents the bureau attitude on the issues involved.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

IN RE OHIO OIL CO. AND SUBSIDIARIES, FINDLAY, OHIO

Mr. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.

DEAR MR. PARKER: Reference is made to your letter of January 10, 1929, concerning your review of certificates of overassessment totaling \$1,850,138.06 for the years 1916 to 1918, inclusive, in the case above indicated and in which you questioned the right of the company to charge incidental development costs to expense in the year 1918 in view of the bureau's previous ruling in the case of the Standard Oil Co. of California where a contrary conclusion was reached upon the facts in that case.

With reference to this question, article 223 of Regulations 45 gives to a taxpayer the option of deducting as an operating expense or of charging to its capital account and returning through depletion such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of property, and further provides that an election once made under this option shall control the taxpayer's returns for all subsequent years. The most pertinent facts as found in the case of the Standard Oil Co. of California and upon which the ruling in that case was based were these. The company filed its 1918 and 1919 returns on a basis of capitalizing incidental development costs and in 1921 filed amended returns for the same years in which these costs were again treated as capital items. In 1923 the company again filed amended returns (unsigned) for the years 1918 and 1919, in which it sought to reverse its policy and charge the development costs previously capitalized to expense. The company argued that the filing of the original returns and the first amended returns did not constitute the exercise of an option but that such option could be exercised at any time before the bureau had completed the final audit of the returns. Upon submission of the question

to Mr. N. T. Hartson, then solicitor of internal revenue, it was held that article 223 did not contemplate or provide that a taxpayer should have the option of treating development costs in a manner so as to produce the lowest tax and that on the facts in the case the taxpayer had clearly exercised an option to capitalize such costs prior to the filing of its second amended returns which option when exercised was binding and could not thereafter be revoked.

The facts in the Ohio oil case with respect to the exercise of an option are entirely different. In this case it was shown that upon the promulgation of regulations 45 in April, 1919, the taxpayer at once realized that due to the difference in the methods prescribed for determining depletion under the 1918 act, as compared with the 1917 act, and in view of the binding option set forth in regulations 45, there was no question but that it preferred to elect to charge its incidental development costs to expense instead of capitalizing the same, as it had done in previous years. Upon realizing this, the officials of the company charged with the duty of handling such matters authorized and directed that the accounts of the company be revised on a basis of charging incidental development costs to expense, and in pursuance of this decision and upon advice of its counsel, the company sent members of its accounting force to Washington to confer with representatives of the bureau as to the compilation of data required by the bureau to effect this change. Upon being fully advised in the matter the accounting force of the company at once commenced a revision of the company's accounts. This necessitated the changing of accounting methods with respect to several thousand wells scattered in a number of different States, so that sufficient data upon which to base a tax return was not gathered until December, 1919. When the company filed its original 1918 return in September, 1919, it had not sufficiently completed its revised accounts, so as a matter of convenience it filed its 1918 return on a basis of capitalizing incidental development costs, but in filing this return it attached a letter thereto stating that additional time would be required for assembling the necessary data for computing depreciation and depletion in accordance with the method prescribed by the bureau, and therefore that it reserved the right to file an amended return at a later date. The taxpayer later offered to file an amended return, but was advised that the same was not necessary in view of the revised depreciation and depletion schedules submitted based upon charging incidental development costs to expense. The revised accounts having been sufficiently completed by December, 1919, the original return for that year filed in March, 1920, was on a basis of charging incidental development costs to expense.

At the time of the first ruling of the general counsel—that of November 27, 1926—the facts in the case were not fully developed, and as the facts were then understood it was ruled that they were not such as to show that the company had exercised an option to expense incidental development costs prior to the filing of the 1918 return. It was later shown, however, that the company by its acts and conduct elected to expense incidental development costs, and that this occurred prior to the filing of its 1918 return. This necessarily required a reversal of the prior ruling. Immediately upon receipt of your letter I arranged for a hearing with you in the general counsel's office in order that the case might be fully considered and the different

views in the case fully understood. Conferences were thereafter held on January 11 and 12, and at the second conference representatives of the company were present to more fully explain the facts in the case. I understand that as a result of these conferences you were convinced that the facts upon which the second ruling of the general counsel was based were true, and that therefore the second ruling rather than the first reached the correct conclusion.

The prior ruling of the general counsel of November 27, 1926, was also premised primarily on the theory that the taxpayer having elected in its 1917 return to capitalize incidental development costs it could not thereafter change its election when it filed its 1918 return. It is true that article 170 of Regulations 33 gave taxpayers the same option with respect to capitalizing or expensing incidental development costs which is given in article 223 of Regulations 45, except that the latter article contains an important provision not found in article 170 of Regulations 33, namely, that an election once made is binding for future years. The depletion provisions of the 1918 act based on an ultimate production basis are decidedly different from those of the 1917 act based on actual reduction in flow and production, which in turn materially affected the period over which capitalized development costs would be charged off and consequently affected the taxpayer's option as to capitalizing or expensing such development costs. In view of the material change in the law and the regulations between the 1917 and 1918 acts there seems to be no question but that an option made under the 1917 act would not be binding under the 1918 act, which made necessary a reversal of the prior ruling of November 27, 1916, in this respect. Substantially the same situation is covered by T. D. 4025, C. B. VI-1, page 75, which holds that "in view of the change in the basis for depletion" in the revenue act of 1926, a new election for the taxable periods ended on or after January 1, 1925, may be exercised with respect to incidental development costs.

In deciding the present case there was no intention to change the principles upon which the ruling in the Standard Oil Co. of California is based. Article 223 of Regulations 45 forms the basis for each ruling and the rulings differ only because of the different set of facts involved in each case. I understand that as a result of the conferences in the general counsel's office you were satisfied that the two rulings were not inconsistent.

Very truly yours,

H. F. MIRES,
Acting Commissioner.

APPENDIX 24(B)

IN RE OHIO OIL CO., FINDLAY, OHIO

TREASURY DEPARTMENT,
Washington, June 15, 1929.

MR. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: On January 10, 1929, you addressed a letter to me, and at about the same time a letter to the commissioner, in

which you raised certain questions as to the propriety of the over-assessments in the above case. Thereafter conferences were held with your staff and the general counsel's office. After careful reconsideration of the matter, the bureau was of the opinion that the overassessments were clearly allowable under the revenue act of 1918 and the regulations promulgated thereunder. The reasons for this conclusion are fully set forth in the commissioner's letter to you of February 15, 1929, which is included in the report as Appendix 24(A). Your previous questions were confined to the proper interpretation and application of the bureau regulations to the particular case, and it is believed that these questions have been answered to your satisfaction.

In the summary of your report to the joint committee, you raise for the first time a question as to the validity of article 223 of Regulations 45. Sufficient time is not now available to permit a thorough study of the grounds upon which the article was based. However, as in case of other provisions of the regulations, this article was reviewed by the Treasury prior to the promulgation of the regulations following Regulations 45, sufficiently to support the conclusion that no new circumstances had arisen indicating the advisability of changing the article. In view of the fact that you have questioned its validity, however, the Treasury is directing a thorough study to be made of the article and of its application and effect. Under these circumstances, it is believed that it will be sufficient for the present to point out rather briefly some of the factors which support the propriety of the provision, and to refer briefly to the points which you present.

Article 223 of Regulations 45 was promulgated in 1919, has been in force (corresponding articles being found in Regulations 62, 65, 69, and 74) for approximately 10 years, and has been approved by Secretaries Glass, Houston, and Mellon and by Commissioners Roper, Williams, and Blair. In addition, the revenue acts of 1921, 1924, 1926, and 1928 have been enacted since the article became effective, and it would seem that the frequently repeated rule of congressional adoption might be considered of possible application. The article reads as follows:

Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may, at the option of the taxpayer, be deducted as an operating expense or charged to the capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as an operating expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years.

The specific objections raised by you to the bureau's action in the case are in regard to "charging drilling costs to expense." This statement of the issue is apt to be misconstrued unless there is an understanding of the nature of the "drilling costs" which fall within the option granted by the regulations. In general, the option is granted only with respect to expenditures which do not directly result in creating or putting in place a tangible asset. Items as to which there is no option are: Actual materials in the physical structures in the well and on the lease, such as derricks, casing, drilling

tools, buildings, pipe lines, tanks, engines, boilers, fueling machines, pumping outfits, and other physical assets. Items which may be expensed under the option are the intangible drilling costs such as wages, hauling, supplies, clearing ground, geological work, shooting and cleaning wells, etc.

The regulations do not contemplate that a taxpayer may change his treatment of such items at will or so as to produce the lowest tax. On the contrary, the regulations provide that an option once exercised will be binding on all future years thereunder. However, because of the material change concerning the determination of the amount of deductible depletion found in section 204 (c) (2) of the revenue act of 1926, taxpayers were given a new option (T. D. 4025, C. B. VI-1, p. 75) with respect to capitalizing or expensing the type of cost here under consideration. Prior to this time, they were bound by whatever election they may have exercised under the 1918 act.

You state that there seems to be a privilege granted oil companies which is not granted other industries. In many industries there are items concerning which there is no settled commercial or accounting practice. They may be either capitalized or charged to operating expense, and regardless of which course is taken in a specific case, the accountants and others interested will differ as to whether the items were properly classified. The bureau recognized that due to the hazardous character of the oil industry, intangible drilling costs in connection with the exploration and development of property were of this type. It also found upon examining the tax returns of many oil companies that there was no consistency in the treatment of such items in the industry. Accordingly, the option under discussion was granted in article 223, Regulations 45, promulgated in April, 1919. This regulation was in no sense intended as a discriminating relief measure. Its basis lay in the fact that dissimilar conditions require differing conclusions. In less hazardous enterprises such differences of opinion respecting the proper treatment of specific expenditures are considerably reduced. However, to the extent that such a difficulty obtains in other industries (e. g., timber, farming, and mining) and is susceptible of such treatment, the bureau has accepted the taxpayer's treatment of the issue and thereby avoided prolonged disputes. See articles 231, 110, 222 of Regulations 45.

With reference to your suggested comparison between the installment sale regulations and the regulations under discussion, it is believed that the situations and problems involved are not related. It is true that if a taxpayer elects to change to the installment sale basis he is required to adjust his invested capital for prior years on account of the change and that a similar requirement is not made a part of the regulations with respect to the option given to oil companies. The history of the controversy over the proper manner of reporting income from installment sales is quite well known. The final outcome of the matter is set forth in sections 212 (d) and 1208 of the revenue act of 1926 and articles 42 to 46, inclusive, of Regulations 69, which are made retroactive to prior years. The installment sale regulations were largely intended to meet both the views of the Board and the bureau. For example, before a taxpayer may adopt the installment sale method of reporting income he must, in effect,

consent to pay a tax on the profits received on the installment payments even though this same profit was taxed in prior years on the accrual basis and he must in addition consent to a determination of invested capital in prior years based on the installment sale basis of reporting income. However, as above indicated the installment sale situation is in somewhat of a class by itself and in many respects hardly comparable to various other regulations.

It is also contended that the charging of the items now under consideration to expense did not in most cases reduce the depletion. This statement seems to be based on the theory that because of the discovery depletion provisions of various acts, certain taxpayers received deductions up to the amount of the limitations thereon. In other words, the argument seems to be confined to specific instances. A charging of the items of the type here under consideration to expense did reduce the amount of depletion; whether this made any difference in the amount of taxes in certain or specific cases because of other factors, such as discovery depletion, net losses, or other offsetting items, is, of course, another matter, and seems to have little bearing on the question of whether charging items of this type to expense affects depletion.

The Treasury will be very glad, in addition to the study which it is directing, to cooperate with you in any further work by you upon the question and to have the benefit of your assistance.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

APPENDIX 25

DECEMBER 8, 1928.

HON. WILLIS C. HAWLEY,

*Chairman Joint Committee on Internal Revenue Taxation,
Washington, D. C.*

MY DEAR CHAIRMAN: Please find attached a copy of the report and decision of the Commissioner of Internal Revenue in the case of the United States Steel Corporation of New York and its subsidiary, the Carnegie Steel Co. of New Jersey. This report was submitted to this committee in accordance with the provisions of section 710 of the revenue act of 1928 on December 5, 1928.

The decision of the commissioner in this case will result in a refund or credit to the above named taxpayers of \$15,756,595.72, with interest.

It appears that the most important point in this case is the method of computing the consolidated invested capital of the United States Steel Co. and its subsidiaries for the taxable year 1917. The bureau admits that it is faced with a dilemma in computing consolidated invested capital and the decisions of the courts, of the Board of Tax Appeals, and the provisions of its own regulations are in conflict. The matter in controversy has never been ruled on by the Supreme Court of the United States. It appears that the invested capital has finally been determined by taking a figure which lies approximately halfway between the invested capital which would be computed under a certain Court of Claims decision and the invested capital which would be computed under regulations of the bureau. The

difference between the two methods is approximately \$69,000,000 and the adjustment made in arriving at a settlement is approximately \$35,000,000.

It can be seen from the above that there is an important principle of policy involved in this case. For the year 1917 alone nearly \$16,000,000 in tax plus interest is involved, and the computation of invested capital in this year will affect the tax liability of the taxpayer in subsequent years down to 1921. It is roughly estimated that in this one consolidated case, if it is settled on the basis proposed, the total amount of refunds, with interest involved, will be approximately \$50,000,000. Moreover, other large cases are still open in the bureau for the year 1917 and subsequent years where invested capital is involved and it appears that the same settlement method will be required in those cases.

This division has, under your direction and that of the former chairman, tried to fulfill the duty laid upon it by the Congress and has made numerous comments to the bureau from time to time in regard to refunds. In the instant case, this office feels that the policy involved is of too great importance to be acted on without the consent and advice of the joint committee itself. Accordingly, it is recommended that the joint committee be called together to consider the method of arriving at invested capital in this case.

It is further suggested that such meeting be set for a date about two weeks hence and that the Commissioner of Internal Revenue be advised that we would like his representative to explain to the committee, in as simple terms as possible, the problem which they have faced in computing the consolidated invested capital of the United States Steel Corporation. The writer will also be ready at that time to make certain comments to the committee on this matter if it is so desired.

Yours respectfully,

L. H. PARKER,
Chief, Division of Investigation.

TREASURY DEPARTMENT,
Washington, December 5, 1928.

HON. WILLIS C. HAWLEY,
*Chairman Joint Committee on Internal Revenue Taxation,
House of Representatives.*

DEAR MR. CHAIRMAN: In accordance with the provisions of section 710 of the revenue act of 1928, directing that a report be submitted to your committee, I transmit herewith a memorandum regarding an overassessment of income tax in the amount of \$4,153.17 in favor of the United States Steel Corporation, New York, N. Y., and an overassessment of \$15,752,442.55 in favor of the Carnegie Steel Co. of New Jersey, Pittsburgh, Pa., for the year 1917. The memorandum prepared by the office of the general counsel, and addressed to the Commissioner of Internal Revenue, describes the circumstances and approves the adjustment.

The period of 30 days during which the overassessments will be withheld from final settlement will expire on January 4, 1929.

Very truly yours,

D. H. BLAIR, *Commissioner.*

IN RE UNITED STATES STEEL CORPORATION AND AFFILIATED CORPORATIONS

OFFICE OF THE GENERAL COUNSEL
OF INTERNAL REVENUE,
December 5, 1928.

MR. COMMISSIONER: The attached certificates of overassessment in the amounts of \$15,752,442.55 and \$4,153.17 for the year 1917 in favor of the Carnegie Steel Co. of New Jersey and the United States Steel Corporation are recommended for approval in order to effect a settlement of cases now pending in the Court of Claims under the names of Adams Mining Co. and 92 Others *v.* United States, Nos. J-448 to J-540, inclusive, in which the taxpayers ask for a refund of \$101,582,180.34, paid as income and profits taxes for the year 1917. The companies involved in the litigation have agreed to place in escrow with the Department of Justice, prior to the issuance of the above overassessments, an order of dismissal of their suits, with prejudice, such order to be filed with the Court of Claims upon the issuance of the overassessments in the amounts stated.

In view of the size of the case and the complicated issues involved, the policy of the taxpayer—consisting of some 195 affiliated companies—during the earlier stages of the cases was to encourage the Income Tax Unit to reach its determination of the matter with the understanding that after such determination the taxpayer would then file a general protest covering all matters with which it was not in agreement. The unit's determination was reached and expressed in audit letters dated December 28, 1925 (approximately 2,400 pages), June 15, 1926, and February 18, 1928.

Thereafter, about June 1, 1928, the taxpayer submitted to the bureau a proposed petition to the Court of Claims in which it set forth in excess of fifty alleged errors in the bureau's prior adjustments of the case and in which the refund of \$101,582,180.34, above referred to, was claimed. Upon examination of the petition and the bureau record in the case, it was found that the taxpayer had duly protected its rights, under the provisions of section 284 (g) of the revenue act of 1926, against the operation of the statute of limitations by filing seasonable waivers and claims and that the time for bringing suit would not expire until July 8, 1928. The taxpayer requested that the merits of its claims as set forth in its petition be considered in the bureau with the object of reaching a settlement if possible before July 8, 1928. With this possible end in view a special committee consisting of a representative from the general counsel's office, a representative from the special advisory committee and one from the Income Tax Unit was appointed to hear the taxpayer's arguments and otherwise consider the merits of its claims. Thereafter all contentions advanced by the taxpayer were carefully considered by the special committee and a number of other issues not raised by the taxpayer but tending to offset the taxpayer's claims were also considered. The committee found, however, that it would not be able to reach a satisfactory conclusion in the matter so as to effect a settlement by July 8 and upon the taxpayer being so advised it filed its petition with the Court of Claims on July 6 in order to protect its rights against the operation of the statute of limitations.

Thereafter the special committee disposed of the issues in the case and its findings are set forth in detail in its original and supplemental

reports dated June 25, 1928, and August 15, 1928, respectively, which reports are now a part of the bureau's file in the case and should be considered as a part hereof.

In view of the numerous issues involved in the case it was thought desirable to present the matter informally to representatives of the Joint Committee on Internal Revenue Taxation prior to the submission of the usual report to them as required by section 710 of the revenue act of 1928. This met with the approval of Mr. L. H. Parker, chairman of the division of investigation of the Joint Committee on Internal Revenue Taxation, who was accordingly furnished with copies of the special committee's reports, taxpayer's briefs, and other pertinent data, after which conferences were held with him and his assistant, Mr. G. B. Chesteen.

As a result of these conferences the representatives of the joint committee did not see fit to recommend any settlement of the case other than that recommended by the special committee nor did they raise any issues which the special committee thought would justify a change in the present settlement. This, however, should not be considered as their final recommendation in the matter. Any issues which the representatives of the joint committee see fit to raise as a result of their future investigations of the case may, of course, be taken up with them at that time.

As a result of these preliminary conferences it was thought that the representatives of the joint committee would have sufficient time to complete such independent investigations of the case as they may care to make within the next 30 days. It is, therefore, recommended that the present report be submitted to the Joint Committee on Internal Revenue Taxation in order that the 30-day period specified in section 710 of the revenue act of 1928 will commence to run.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved December 5, 1928.

D. H. BLAIR,

Commissioner of Internal Revenue.

APPENDIX 26

DECEMBER 20, 1928.

HON. WILLIS C. HAWLEY,

*Chairman Joint Committee on Internal Revenue Taxation,
House of Representatives.*

DEAR MR. CHAIRMAN: I inclose herewith a memorandum in which we have attempted to outline briefly the principal points presented to the committee at its sessions on Monday last with reference to the proposed refund to the United States Steel Corporation and affiliated companies for the year 1917. If you desire the memorandum enlarged to give more detail with reference to any matters, I shall be very glad to furnish the additional data. As you know, the Treasury transmitted a detailed report to the committee at the time the proposed refund was submitted.

I will also forward to you to-day mimeographed copies of the memorandum for distribution, if you desire, to each member of the committee and your staff.

Very truly yours,

HENRY HERRICK BOND,
Assistant Secretary.

OUTLINE MEMORANDUM SUBMITTED BY TREASURY DEPARTMENT RELATING TO THE PROPOSED REFUND OF INCOME AND EXCESS PROFITS TAXES FOR 1917 TO THE UNITED STATES STEEL CORPORATION AND AFFILIATED COMPANIES

(1) Corporation history:

United States Steel Corporation organized April 1, 1901.

Stock of 13 operating companies acquired by syndicate and turned over to new corporation, United States Steel Corporation, which was and always has been only a holding company.

New corporation issued (in round figures) \$508,000,000 common, \$510,000,000 preferred, \$303,000,000 bonds, \$81,000,000 notes and miscellaneous obligations, totaling \$1,402,000,000.

The 13 corporations whose stock was acquired in turn owned stock of a large number of subsidiaries.

Between 1901 and 1917 various reorganizations in the group effected and subsidiaries added, some during 1917.

In 1917 a total of 195 corporations in the group—i. e., the parent, 13 subsidiaries in the relation of children, and 181 subsidiaries of subsidiaries, whom we may call grandchildren or great-grandchildren.

(2) Taxes paid for 1917:

The tax on the original return was \$199,850,857.46, filed April 16, 1918.

Subsequently, following a so-called "superficial audit" an amended return was filed September 29, 1919, showing \$7,190,165.71 additional, which was paid. This was less than the amount shown by the superficial audit, the difference being abated.

Following a change in article 170 of regulations 33 there was assessed and paid an additional \$6,369,497.75, on December 3, 1920.

The first comprehensive bureau audit (by Forster) indicated a still further tax of \$9,426,115.14. The taxpayer conceded a payment of \$4,000,000 and this was assessed and paid August 29, 1921, pending further audit.

These additional payments were made by the company in accordance with its settled policy to pay amounts claimed, without filing protests and holding conferences to determine correct tax, and to file claims for refund after payment, trusting to the department to reach correct adjustment ultimately and refund whatever was due. (We have had the use of this money for from seven to nine years.)

(3) Proposed refund:

The proposed refund is for \$15,756,595.72 tax, and approximately \$11,000,000 interest, or a total of something over \$26,000,000.

The company, to protect its rights, began proceedings last July in the Court of Claims and claimed a total refund of \$101,000,000 tax and approximately \$60,000,000 interest, to which would be added interest of 6 per cent up to the date of final judgment by a court of last resort.

(3) Proposed refund—Continued.

Subsequent audit work in the bureau indicated overassessments of approximately \$28,000,000, and this amount with interest making a total of approximately \$31,000,000 was credited against deficiencies then being claimed for subsequent years instead of being refunded. This credit will be worked out and adjusted when the taxes for those years are finally made.

The proposed refund is based on exhaustive consideration of the entire case by a special committee of three of the most able and experienced men in the bureau, working in conjunction with auditors who have devoted literally years of time to the case. Their unanimous recommendation of this refund has received the approval of the general counsel and the commissioner after careful examination.

Final letter to taxpayer on 1917 alone embraces 2,400 closely typewritten pages.

The files relating to the case comprise probably several hundred thousand pages and no one could comprehend all of the details involved without devoting at least a year to its study.

While the entire overassessment (including the refund now proposed and the credits heretofore made) is large in amount, proportionately it represents only 13 per cent of tax shown on original return. If on a tax of \$100,000 a refund of \$13,000 were made, it would pass unnoticed and would be so small that this committee would not be interested.

(4) Principal issue.

Principal issue raised by staff of joint committee involves computation of consolidated invested capital, under revenue act of 1917 and regulations thereunder. It is believed that the staff does *not* think that the method adopted by the bureau produces the *wrong result*, but merely that the question is of such importance that the staff could not assume responsibility without bringing it to the attention of the committee.

Treasury informally advised that no questions are raised as to computation of income and that disposition of this part of the case is satisfactory.

(5) The question.

Stated briefly, the question involved is, How much of the cost to the parent corporation of its stock in the subsidiary is to be included in computing consolidated invested capital?

For example, corporation P bought all the stock of corporation S for \$1,000,000 (paid either in cash or its own stock). S, *at the time of the purchase*, had tangible assets of \$600,000 and intangible assets (good will) of \$400,000: Is P entitled to its fair profit (in accordance with the act) upon the \$1,000,000 investment before paying the "excess-profits" tax? Or, should the investment of S be the measure? Or is there an intermediary method of determining invested capital?

(6) The statute:

This question arises in this case under the provisions of the revenue act of 1917, relating to the computation of "invested capital," upon which a corporation is entitled to a "fair return" (defined in the statute) before being called upon to pay a tax upon its "excess profits." The same question arises in other cases under the revenue act of 1918. In order to avoid other complications not here involved, the language of the statute will not be quoted. Eliminating points not here involved the statute provides that in the case of a separate corporation invested capital should include:

(a) Tangible property.

The actual cash value of tangible property paid in for stock must be included.

(b) Intangible property.

The actual cash value of intangible assets (such as good will) paid in for stock is included, subject to the limitation that it can not exceed 20 per cent of the par value of the stock outstanding on March 3, 1917. Intangible assets developed by the corporation itself, for example, and *not* paid in for stock are excluded entirely.

(c) "Inadmissibles" (i. e., stock).

Corporate stock is considered a tangible asset but is included (for 1917) only up to the amount of the indebtedness of the corporation owning it.

(7) Four rules of possible application:

Four distinctly different rules are of possible application in determining the question (stated in (5) above) for a consolidated group:

(a) The Treasury Regulations (article 868 of regulations 45).

(b) The decision of the Court of Claims in the United Cigar Stores case (62 Ct. Cl. 134).

(c) The decision of the Board of Tax Appeals in the Grand Rapids Dry Goods Co. case (12 B. T. A. 969).

(d) The so-called "legal theory" advanced by the attorneys of the Steel Corporation in this case.

(8) The Treasury regulations:

The regulations (the rule having been in force since 1919) treat the transaction, in accordance with the business or accounting view, as though the parent corporation actually acquired the assets of the subsidiary, rather than the stock, and provide that there should come into consolidated invested capital the value of the tangible and intangible assets of the subsidiary *at the time of the transaction*, thus subjecting intangible assets of the subsidiary to the 20 per cent limitation.

(9) The United Cigar Store's decision:

The Court of Claims, in the case of the United Cigar Stores Co. of America *v.* United States, held that there should come into consolidated invested capital the *value of the stock* of the subsidiary at the time acquired by the parent company. The Court of Claims agrees with the regulations in that the valuation should be *at the time the stock of the subsidiary is acquired* by the parent, but under this decision the *limitation* upon the *intangibles* is not applicable and apparently the limitation upon "*inadmissibles*" (i. e., stock of another corporation) is not applicable. In reaching its decision, the Court of Claims reasoned that since stock, a tangible asset, was acquired, the bureau was not justified in saying that tangible and intangible assets were acquired and then subjecting the intangible assets to the limitation provision prescribed in section 207.

(10) The Grand Rapids Dry Goods Co. decision:

The Board of Tax Appeals, in the appeal of Grand Rapids Dry Goods Co. (June 19, 1928), differs with both the bureau and the Court of Claims *as to the time* the assets of the subsidiary should be valued in computing consolidated invested capital. The board holds that the subsidiary's invested capital should be computed separately under the provisions of section 207. Under this theory the cost of the stock to the parent is disregarded, and it is necessary to go back to the original incorporation of the subsidiary in order to determine the amount of cash paid in for stock, tangible property paid in for stock, intangible property paid in for stock, and its earned surplus and undivided profits accumulated between the time of its original organization and the time of the acquisition of its stock by the parent company. Briefly, the effect of this rule is that all appreciation and depreciation in the value of tangible property from the time it was paid in to the subsidiary to the time the parent acquired the subsidiary's stock, will be disregarded, and the value of the intangibles developed by the subsidiary will be disregarded. Obviously, the subsidiary's invested capital so computed would in the ordinary case be quite different from a computation based on a valuation *as of the time the subsidiary's stock* is acquired by the parent company. The board would trace the assets of the subsidiary back to its organization, whereas the bureau and the Court of Claims would make the valuation at the time the parent acquired the subsidiary's stock.

(11) The so-called "legal" theory:

The legal theory, often advanced as being the right answer to the question, would bring in the capital of the subsidiary computed separately, as in the Grand Rapids Dry Goods decision, and then would include as a part of the capital of the parent the stock of the subsidiary subject to the limitation upon "*inadmissibles*." Under this theory the stock would stay in invested capital up to the amount of the parent's indebtedness.

(12) The rule applied in United States Steel case:

Prior to the United Cigar Stores case the bureau was applying to this case, as to all other cases involving the point, the rule of the regulations. After the United Cigar Stores case was dismissed by the Supreme Court of the United States, on motion of the Solicitor General (after conferences with the general counsel), the bureau was engaged in working out the effect of that case upon the Steel case. In order to prevent the running of the statute of limitations, however, the Steel Corporation was compelled to file suit in the Court of Claims, in which it claimed a refund of approximately \$101,000,000 in taxes and approximately \$60,000,000 in interest. The Commissioner of Internal Revenue thereupon instructed the special committee previously appointed to continue the work upon the case in an effort to avoid litigation if possible.

The decision of the Court of Claims in the United Cigar Stores case required an increase in invested capital of \$69,000,000, notwithstanding valuations decidedly favorable to the Government and finally accepted by the taxpayer. There is no doubt that, if the case were to be settled by litigation, much greater values would be proved by the taxpayer and determined by the court.

After the decision of the board in the Grand Rapids case, and as a result of further negotiations, this amount was reduced by approximately one-half.

However, as a result of concessions and off-setting items discussed with the committee, the invested capital as finally agreed upon does not exceed the amount properly computed under the regulations.

(13) Applicability of Grand Rapids decision:

As a general proposition, the rule of the board in the Grand Rapids case will be more favorable to the taxpayer than the regulations whenever there has been a depreciation in value and less favorable whenever an appreciation in value. However, it is impossible to determine the effect of this decision upon the Steel case (the decision was handed down last June), and even the probable result can not be predicted. The following points must be considered:

(a) The Treasury has no assurances that the Grand Rapids decision would be followed by the Supreme Court—and it would be necessary to go to the Supreme Court, for the Court of Claims would likely apply its own rule as enunciated in the United Cigar Stores case.

(b) It would be necessary to go back through the history of all the 195 subsidiaries, some of which are a century old—an obviously impossible task.

(13) Applicability of Grand Rapids decision—Continued.

As a general proposition, etc.—Continued.

- (c) The effect or reorganizations prior to 1917 (of which there have been a large number) greatly decreases any benefits to the Government. For example, the decision of the Board of Tax Appeals in the Regal Shoe Co. case (1 B. T. A. 896), in which the board held that where a corporation acquired the stock of another corporation and shortly thereafter dissolved it and took over its assets, the full value of the stock acquired should come into invested capital; and other decisions involving reorganizations of subsidiaries and intercompany transactions prior to 1917.
- (d) The Grand Rapids case was a *cash* for stock transaction, and there is no case applying its principles to a *stock* for stock transaction, such as involved in the Steel case.
- (e) The Grand Rapids case does not afford any ground for adopting a method for computing the invested capital of the parent corporation in a *stock* for stock transaction—and it is not impossible that the so-called legal theory would be approved, the rule *most favorable* to taxpayers and increasing invested capital in this case several hundred million dollars.

(14) Additional considerations:

If the Steel case is not settled administratively, it must be remembered in addition to the above that—

- (a) The substantial concessions of the taxpayer will be withdrawn.
- (b) The taxpayer will have an opportunity (of which he will be expected to take advantage) to raise points favorable to it involving substantial amounts not heretofore raised or pressed—and there are several such points.
- (c) It is estimated that the litigation will require the services of at least 25 experts for a period of at least three years; and that a final decision can not be expected within five years.
- (d) The Government will have to pay interest at the rate of 6 per cent upon the entire amount determined to have been overpaid.
- (e) That years subsequent to 1917 can not be closed until 1917 is finally determined, with interest costs increasing upon the amounts (if any) to be refunded.

(15) Taxpayer's concessions involving income:

The following matters claimed by taxpayer in pending court proceedings have been conceded by company on this proposed settlement:

- (a) A technical question on interest limitation, affecting tax by \$153,000.
- (b) Method of reducing invested capital by 1916 tax, affecting tax by \$480,000.

(15) Taxpayer's concessions involving income—Continued.

The following matters claimed by taxpayer, etc.—Con.

- (c) Various income adjustments relating to matters, such as prorating of premiums on bonds, Pennsylvania tax on bonds, inventory basis of "stock piles," taxes paid in Minnesota and Michigan added to inventory, taxability of profits from leased lands in Minnesota, deduction of stock purchased and distributed to employees as compensation, etc., affecting income over \$5,860,000. Equivalent to tax of over \$3,500,000 and interest for over nine years at 6 per cent.

(16) Conclusions:

- (a) The only point in the entire case which has been raised by the staff of the joint committee relates to the computation of invested capital, the adjustment of the many other issues being satisfactory. And the committee's staff *does not contend that the proposed adjustment of this point is wrong*—they have merely invited the committee's attention to the importance of the problem, in order to obtain the benefit of the committee's consideration and instructions.
- (b) The Treasury is certain that the proposed settlement of the case is unquestionably in the best interests of the Government.
- (c) The Treasury does not expect the committee to approve the refund. To do so would require it to devote months to an exhaustive study of the case.
- (d) If the committee disapproves, however, it should assume full responsibility for the ultimate decision.

 APPENDIX 27

DECEMBER 16, 1928.

The Commissioner of Internal Revenue on December 5 submitted to the joint committee under the provisions of section 710 of the revenue act of 1928 a report and his decision in regard to a refund to the United States Steel Corporation and one of its subsidiary companies. The amount of the refund proposed is \$15,756,595.72 for the taxable year 1917, exclusive of interest. A copy of the report and the decision of the commissioner was furnished each member of the committee at the time this meeting was called.

A few words on the history of the United States Steel Corporation case seems proper. This corporation filed its original returns for 1917 in April, 1918. They were filed, as far as the excess-profits tax was concerned on the basis of consolidated returns. In other words, one return was filed for the United States Steel Corporation and its 195 subsidiaries. After the original returns were filed, amended returns were made in December, 1919. Since these returns were filed various audits have been made, the results of the most important of these audits, including the results of the returns and the final adjustment are shown in Table I attached.

The figures in Table I may be summed up as follows:

From April, 1918, to August, 1921, the United States Steel Corporation and its subsidiaries paid to the Treasury in income and excess-profits taxes on account of the taxable year 1917 a total of \$217,577,-584.22, either on the basis of their returns or on the assessments of additional tax made by the bureau. Subsequent to August, 1921, the bureau has admitted that a net amount of \$28,299,574.68 represents an overassessment, and this amount has either been refunded or credited against the taxes of subsequent years. The balance or the net payment remaining in the Treasury of the United States up to this date is then \$189,278,019.54. The commissioner now proposes an additional refund of 1917 tax amounting to \$15,756,595.72, which, if made, will represent a final determination of 1917 tax in this case in the amount of \$173,521,423.82. It might be noted that this final tax liability is \$26,329,433.64 less than the amount voluntarily reported and paid by this corporation on its original returns as filed.

The statement made seems sufficient to give some idea of the size and importance of this case, and it is now desired to say a few words in regard to the issues involved in the final determination proposed. The issues are of two general kinds, (1) income adjustments and (2) invested-capital adjustments.

In regard to the income items which were at issue, it may be stated that the division of investigation has made a general examination of the most important of these items and it is found that the taxpayer has conceded income items in the amount of approximately \$5,862,000, and the Government has conceded income items in the amount of approximately \$5,438,000. The issues in regard to income appear really doubtful, and as the Government seems to have the best of the bargain by about \$424,000, or some \$275,000 in tax, it is recommended that the consideration of these items be dismissed, with the understanding that the staff of the committee will complete certain checks now under way in regard to these adjustments.

The second and remaining issue concerns the method of determining the consolidated invested capital for the year 1917. In fact, this is the main and most important issue in this case from all standpoints.

The war revenue act of 1917 did not provide for consolidated returns, but regulations 41 of the bureau permitted or even required such returns. These 1917 regulations were legalized by the retro-active provisions of section 1331 of the revenue act of 1921.

As far as the revenue act of 1921 is concerned or the original regulations 41 no method of computing consolidated invested capital is set up. The only rule that is found in the law relates to the ordinary separate corporation and is found in section 207 of the revenue act of 1917. For the convenience of the reader, this section is attached in Exhibit A. For the same purpose section 1331 of the revenue act of 1921, which authorizes consolidated returns for 1917, is shown in Exhibit B, and the regulations 41, referring to the computation of the invested capital of separate corporations, is shown in Exhibit C.

The documents in this case show that the representatives of the bureau have been in a dilemma in determining the consolidated invested capital of this company for 1917. The regulations issued by the bureau and found in Exhibit C have been overturned first by the United States Court of Claims in the case of the United Cigar Stores Co. of America *v.* United States, decided on April 26, 1926,

and again by the United States Board of Tax Appeals in the case of the Grand Rapids Dry Goods Co. on June 19, 1928. (The decisions in these cases will be found in Exhibits D and E, respectively.) Moreover, the theory advanced by the board is inconsistent with the theory advanced by the Court of Claims. Although a writ of certiorari was granted by the Supreme Court of the United States in the United Cigar Stores case, this has been withdrawn on motion of the Solicitor General. It appears that in the Board of Tax Appeals case the commissioner will neither acquiesce nor appeal.

It also appears that the bureau has used great care in arriving at the final determination, for the case has been assigned to a special committee, consisting of a representative of the general counsel's office, a representative of the special advisory committee, and a representative of the audit division. The taxpayer has been represented by Wayne Johnson, Esq., former Solicitor of the Bureau of Internal Revenue during a portion of the excess profits tax years, and a number of other attorneys.

The final consolidated invested capital in this case appears to have been agreed on between the Government's representatives and the taxpayer, as follows:

Invested capital on Court of Claims theory.....	\$1, 218, 000, 000
Arbitrary reduction conceded by taxpayer.....	35, 000, 000
Final amount allowed.....	1, 183, 000, 000

The invested capital under the bureau regulations is approximately \$1,149,000,000, or \$34,000,000 less than allowed. The invested capital under the Board of Tax Appeals decision has never been computed on account of the great difficulty encountered in securing the necessary facts. The documents of the bureau state that the bureau has used the board decision as "a trading horse" to influence the taxpayer to accept a lower value than the Court of Claims decision would allow.

To sum up, it may be said that the correct method of determining consolidated invested capital is not definitely known, and that, therefore, the main issue in this case is a matter of policy, there being two alternatives:

1. To make the best business settlement possible on an arbitrary basis.

2. To carry the case through the courts.

The division of investigation, which is under my direction is essentially a fact-finding body, and I believe I would have been direct in my duty if I did not call this case to the attention of the committee, as a strict statutory basis is not followed, and the policy used can be more competently passed on by the members of the committee than by myself. It has been my aim only to briefly sketch the main features of this case and not to bias the minds of the committee in any way.

Finally, I would call the attention of the committee to the fact that not only does the determination of invested capital in this case for 1917 affect the taxes for the years 1918 to 1920 in this case if adhered to in these subsequent years, but also I have been informed that the general counsel's office will meet the same questions in other important cases for the invested capital years and that the same arbitrary basis will be used. The issue, therefore, is of greater importance than with mere reference to this one large case.

L. H. PARKER.

TABLE I.—United States Steel Corporation, schedule showing for 1917 the income, invested capital, and tax liability disclosed by original returns, amended return, and each succeeding audit

	Consolidated income	Consolidated invested capital	Variable deduction (per cent)	Excess profits tax	Income tax	Total tax liability before deducting discount	Increase (+) or decrease (-) in tax liability	Reduction of discount	Additional tax paid (+) or overassessment allowed (-) -
Original return Form 1103 filed Apr. 16, 1918.	\$568,964,089.71	\$1,427,223,402.62	7.811193	\$173,504,430.27	\$26,340,427.19	\$199,850,857.46	-	-	-
Amended return Form 1103 filed Dec. 29, 1919.	533,588,896.12	1,173,851,098.83	8.206455	181,153,542.73	25,887,480.44	207,041,023.17	+ \$7,190,165.71	-	\$7,190,165.71
Voluntary payment, account of art. 170, Regulations 33, revised, paid Dec. 3, 1920.	-	-	-	-	-	213,410,520.92	+6,369,497.75	-	6,369,497.75
Bureau audit dated Jan. 27, 1921 (Forster).	548,288,897.42	1,096,270,248.77	-	197,420,308.60	25,416,327.46	222,836,636.06	1+9,426,115.14	-	Not assessed.
Voluntary payment, account donations to war activities, paid Feb. 14, 1921.	-	-	-	-	-	213,577,594.22	+167,073.30	-	167,073.30
Assessment, account Forster audit, paid Aug. 29, 1921.	-	-	-	-	-	217,577,594.22	+4,000,000.00	-	4,000,000.00
Bureau audit dated Dec. 28, 1925 (Salanio).	492,674,347.98	1,090,652,815.30	9	168,325,670.94	26,572,956.45	194,898,627.39	-22,678,966.83	\$57,463.91	-22,621,502.92
Bureau audit dated Nov. 24, 1926.	492,756,235.95	1,091,438,289.60	9	168,280,546.83	26,580,577.17	194,861,124.00	-37,503.39	-	-37,503.39
Bureau audit dated Dec. 20, 1927 (scheduled Feb. 14, 1928).	485,018,695.00	1,061,438,289.60	9	163,638,022.26	26,712,210.45	190,350,232.71	-4,510,891.29	18,146.03	-4,492,745.26
Bureau audit dated Feb. 13, 1928.	485,018,695.00	1,071,655,008.05	9	162,412,016.04	26,785,770.82	189,197,786.86	-1,152,445.85	4,022.74	-1,147,823.11
Bureau final audit (committee).	479,613,187.53	1,183,777,479.92	8.903510	145,942,460.31	27,435,271.42	173,377,731.73	-15,820,055.13	63,459.41	-15,756,596.72

Forster's audit shows additional tax of.....	\$9,447,359.16
Which includes additional munitions tax.....	18,489.60

	9,429,069.50
Balance representing additional income and profits tax.....	2,954.42
unaccounted for.....	-----

Additional tax shown above

9,426,115.13

EXHIBIT A

DEFINITION OF INVESTED CAPITAL—WAR REVENUE ACT, APPROVED OCTOBER 3, 1917

SEC. 207. That as used in this title, the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in; (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor); and (3) paid in or earned surplus and undivided profits used or employed in the business exclusive of undivided profits earned during the taxable year: *Provided*, That (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not to exceed the par value of such stock or shares at the time of such payment, and (b) the good will, trade-mark, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March 3, 1917, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to March 3, 1917), in an amount not to exceed, on March 3, 1917, 20 per cent of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock.

EXHIBIT "B"

RETROACTIVE PROVISIONS OF REVENUE ACT OF 1921 LEGALIZING CONSOLIDATED RETURNS UNDER REVENUE ACT OF 1917—CONSOLIDATED RETURNS FOR YEAR 1917

SEC. 1331. (a) That Title II of the Revenue Act of 1917 shall be construed to impose the taxes therein mentioned upon the basis of consolidated returns of net income and invested capital in the case of domestic corporations and domestic partnerships that were affiliated during the calendar year 1917.

(b) For the purpose of this section a corporation or partnership was affiliated with one or more corporations or partnerships (1) when such corporation or partnership owned directly or controlled through closely affiliated interests or by a nominee or nominees all or substantially all the stock of the other or others, or (2) when substantially all the stock of two or more corporations or the business of two or more partnerships was owned by the same interest: *Provided*, That such corporations or partnerships were engaged in the same or a closely related business, or one corporation or partnership bought from or sold to another corporation or partnership products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or one corporation or partnership in any way so arranged its financial relationships with another corporation or partnership as to assign to it a disproportionate share of net income or invested capital. For the purposes of this section, public service corporations which (1) were operated independently, (2) were not physically connected or merged and (3) did not receive special permission to make a consolidated return, shall not be construed to have been affiliated; but a railroad or other public utility which was owned by an industrial corporation and was operated as a plant

facility or as an integral part of a group organization of affiliated corporations which were required to file a consolidated return, shall be construed to have been affiliated.

(c) The provisions of this section are declaratory of the provisions of Title II of the revenue act of 1917.

EXHIBIT C

[Extract from Regulations 41, Treasury Department, on war revenue act of October 3, 1917]

INVESTED CAPITAL—CORPORATIONS AND PARTNERSHIPS

ART. 53. *Rule for computing invested capital.*—In computing invested capital, every corporation or partnership paying taxes at the graduated rates prescribed in section 201 (see art. 16), shall add together its paid in capital and its paid in or earned surplus and undivided profits (under whatever name the same may be called) as shown by its books at the beginning of the taxable year. The total thus obtained shall be adjusted for any asset or item which it covers that is not carried on the books at the valuation prescribed by law or by these regulations. When necessary, adjustment (addition or subtraction) shall be made in respect of the following:

ADJUSTMENTS

1. Stock or shares issued in the purchase of intangible property prior to March 3, 1917, which can not be included in an amount exceeding (a) 20 per cent of the par value of the total stock or shares outstanding on that date, (b) the actual value of such intangible property at the date acquired, or (c) the par value of the stock or shares issued in payment therefor, whichever is the lowest. (See arts. 57 and 58.)

2. Stock or shares issued for a mixed aggregate of tangible property, patents and copyrights, and good will or other intangible property. (See art. 59.)

3. Stock or shares issued for patents and copyrights, valued at (a) their actual cash value at the time of payment, or (b) the par value of the stock or shares issued therefor, whichever is lower. (See art. 56.)

4. Stock or shares issued for tangible property prior to January 1, 1914, valued at (a) the actual cash value of such property on January 1, 1914, or (b) the par value of the stock, whichever is lower. (See art. 55.)

5. Stock originally issued for property and subsequently returned to the corporation as a gift, etc. (See art. 54.)

6. Add any proportion of its permanent indebtedness which may be included under article 44.

7. Add value of tangible property paid in for stock or shares in excess of the par value of such shares, when authorized by article 63.

8. Add amounts expended in the past for (a) the acquisition of tangible property or (b) specifically for good will and other similar intangible property, when authorized by article 64.

9. For the valuation of assets acquired in reorganizations, etc., (a) effected after March 3, 1917, see article 50; (b) as to the pre-war period, see articles 49 and 51.

10. Deduct amounts representing appreciation excluded by article 42.

11. Make any additional deductions required by reason of insufficient allowances in the accounts of the taxpayer for depletion, depreciation, and obsolescence. (See art. 42.)

EXHIBIT D

[Extracts from decision of Court of Claims of United States No. C-43, decided April 26, 1926]

UNITED CIGAR STORES CO. OF AMERICA v. UNITED STATES

Under section 207 of the revenue act of 1917, stock of another corporation acquired by a taxpayer in exchange for its own stock is treated as an issue of stock for tangible property, for purposes of invested capital, and not subject to the 20 per cent limitation on intangibles.

In 1912, at the time the stock of the Corporation of United Cigar Stores was purchased by the United Cigar Stores Co. of America with the stock of the latter, and also on January 1, 1914, the actual cash value of the entire net assets of said New Jersey company, after deducting from its gross assets its liabilities, including its bonds and preferred stock, was as follows:

Tangible property, including cash, bills, accounts, and notes receivable, real estate, leases on real estate, merchandise, etc.....	\$5, 762, 000
Intangible property consisting of good will, trade-marks, trade names, trade-brands.....	21, 400, 000
Total.....	27, 162, 000

EXHIBIT E

[Extract from United States Board of Tax Appeals Reports. Appeal of Grand Rapids Dry Goods Co. (Docket No. 3642), promulgated June 19, 1928]

Consolidated invested capital.—Company B was organized in 1912, with a paid-in capital of \$60,000. It operated at a loss until August 1, 1919, when its stockholders sold all of their stock to company A for \$15,000 cash. Company B paid no dividends prior to December 31, 1919. Held, that Company B should be included in the consolidated invested capital for the year 1919 at \$45,000.

PART IV

LETTER OF SUBMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, February 18, 1929.

HON. WILLIS C. HAWLEY,
Chairman Joint Committee on Internal Revenue Taxation,
Washington, D. C.

MY DEAR CHAIRMAN: There is submitted herewith the second report on refunds, credits, and abatements reported to the Joint Committee on Internal Revenue Taxation under the urgent deficiency bill, H. R. 16462.

This report covers in detail the period November 1, 1927, to April 24, 1928. A former report dated December 8, 1927, covered the period March 1, 1927, to November 1, 1927. The statistical analysis of these overassessments made in this second report is inclusive of the statistics compiled for the first report. This method seems proper, as it gives us facts based on a longer and more representative period.

In the opinion of the writer, the most important facts brought out by this report are as follows:

First. Nearly 89 per cent of these overassessments are for taxable years prior to 1922, or in other words, are for the period during which the excess-profits tax was in force. When these old tax cases are closed, there should be a very marked decrease in the amount of refunds necessary.

Second. The most troublesome provisions of the excess-profits tax years are special assessment, invested capital, and amortization. These provisions are not found in our present law.

Third. The most troublesome provisions of our present revenue act are those requiring valuations, such as estate tax, depreciation, inventories, obsolescence, depletion, and gain or loss.

Fourth. The great majority of the overassessments appear to be above criticism. There are relatively few doubtful cases where the opinion of this division differs with the findings of the Commissioner of Internal Revenue.

Respectfully submitted.

L. H. PARKER,
Chief, Division of Investigation.

PART IV

SECOND REPORT UNDER URGENT DEFICIENCY ACT OF FEBRUARY 28, 1927

FOREWORD

The urgent deficiency bill (H. R. 16462) was approved on February 28, 1927. This bill, which appropriated \$175,000,000 for the purpose of refunding taxes illegally collected, also provided that no part of the appropriation should be available for paying any claims in excess of \$75,000 until after the expiration of 60 days from the date upon which a report giving the name of the person to whom the refund was to be made, the amount of the refund, and a summary of the facts and the decision of the Commissioner of Internal Revenue was submitted to the Joint Committee on Internal Revenue Taxation.

Refunds under this bill were reported to the joint committee during the period February 28, 1927, to April 24, 1928. A report has already been made on the portion of these refunds reported to the committee from February 28, 1927, to November 1, 1927. This first report was divided into two parts; namely, (1) a general survey of refunds, credits, abatements and interest, and (2) a study of individual cases.

In this second report the same plan is followed and the subject will be divided into two parts, as in the first report. It is thought more useful, however, to include in Part I (the general survey), the complete figures from February 28, 1927, to April 24, 1928; or, in other words, the analysis of total amounts reported is inclusive of the former report made under date of December 8, 1927. In the case of Part II (the individual cases), however, it seems only necessary to add those remarks on such cases as seem instructive which were reported to the joint committee during the period November 1, 1927, to April 24, 1928. It would serve no useful purpose to repeat the comments already made in the first report on individual cases submitted to the committee from February 28, 1927, to November 1, 1927.

SYNOPSIS OF PART I

GENERAL SURVEY OF REFUNDS, CREDITS, ABATEMENTS, AND INTEREST

(For the period February 28, 1927, to April 24, 1928)

1. The total number of cases reported where claims have been allowed in excess of \$75,000 amounts to 500.

2. The figures involved in these allowed claims are as follows:

Total refunds.....	\$55, 300, 169. 94
Total credits.....	18, 880, 113. 89
Total abatements.....	23, 474, 978. 25
<hr/>	
Total overassessments.....	97, 655, 262. 08
Total interest allowed.....	19, 974, 793. 36
<hr/>	
Grand total of allowances.....	117, 630, 055. 44

3. The amount of the above allowances payable from the appropriation of \$175,000,000 is the amount of the refunds plus the interest allowed or the sum of \$75,274,963.30.

4. It follows that *43 per cent* of the total of the cash refunds is allowed in cases where the refund is in excess of \$75,000.

5. The average rate of refundment with interest during the period February 28, 1927, to April 24, 1928, in all cases, both more or less than \$75,000, was approximately \$12,500,000 per month.

6. An analysis has been made of the overassessments in excess of \$75,000, which shows that the principal reasons for such overassessments are due to the application of provisions in the revenue acts found only in the excess-profits tax years ending with 1921. The percentage of overassessments, due to only three of these provisions of the excess-profits tax years, to the total of all overassessments examined, is shown below:

	Per cent
Special assessment (\$18,440,835)-----	18. 88
Invested capital (\$11,986,467)-----	12. 27
Amortization (\$10,180,706)-----	10. 43
Total (\$40,608,008)-----	41. 58

7. Analysis shows that the principal reasons for overassessments due to the application of provisions found in the revenue act of 1928, as well as in prior acts, are as follows:

	Per cent
Estate tax (\$10,913,114)-----	11. 18
Depreciation (\$7,471,672)-----	7. 65
Affiliation (\$7,203,267)-----	7. 38
Inventory adjustments (\$6,387,807)-----	6. 54
Valuations (\$2,464,075)-----	2. 52
Obsolescence (\$2,089,211)-----	2. 14
Depletion (\$1,826,255)-----	1. 87
Total (\$38,355,401)-----	39. 28

8. The facts shown in (6) and (7) above make it apparent that the special assessment and invested capital provisions of the revenue acts of 1917, 1918, and 1921 are the most troublesome provisions ever written into our revenue law and are still the cause in 1927 of over 40 per cent of all refunds, credits, and abatements. It is also apparent that the most troublesome provisions in our present revenue act are those necessitating (1) *the valuation of estates*; (2) *the consolidation of returns for affiliated companies*; (3) *the determination of depreciation, obsolescence, and depletion*; (4) *the valuation of inventories*; and (5) *valuations for determining gain or loss*. It is evident that the future simplification of the income tax law must of necessity rest largely on a more simple and definite method of determining valuations and other questions of judgment.

9. Overassessments for the years prior to 1922 represent nearly 89 per cent of the total overassessments, leaving only about 11 per cent of such overassessments allowed for 1922 and subsequent years. When all tax cases prior to 1922 have been settled, therefore, a very great reduction in the amount of refunds may be expected. It is not apparent, in view of the increasing annual appropriations for refunds, that the peak of these repayments of tax has been reached as yet.

SYNOPSIS OF PART II

STUDY OF INDIVIDUAL CASES

(For the period November 1, 1927, to April 24, 1928)

The reports and decisions of the Commissioner of Internal Revenue in connection with all overassessments in excess of \$75,000 have been reviewed by this division. The total number of cases thus examined in the period November 1, 1927, to April 24, 1928, amounts to 177. The results of this review are summarized as follows:

1. In general, the decisions of the commissioner submitted to this office appear to be obviously legal and proper on their face.

2. The review of the overassessments is instructive as to the operation and effect of our revenue acts, and as to certain inequitable results permitted under such acts.

3. One hundred and fifty-five cases, or 88 per cent, have been clearly proper and allowable on the basis of the facts shown in the report of the commissioner to the joint committee.

4. Twenty-two cases, or 12 per cent, have seemed doubtful on the report of the commissioner and have been specially investigated through the files of the Bureau of Internal Revenue or upon special inquiry addressed to the authorized representative of the Treasury Department.

5. In regard to the 22 seemingly doubtful cases, after special investigation, the following classification can be made:

Fifteen cases seemed proper.

Four cases still appeared doubtful either as to the law or the facts.

Three cases were not computed in accordance with the views of this division and the Treasury Department was so notified.

6. Of the three cases specifically questioned, the department maintained its position in two cases, and corrected the third case, resulting in a net reduction in the overassessment of \$7,265.39.

PART I

GENERAL SURVEY OF REFUNDS, CREDITS, ABATEMENTS, AND INTEREST

The statistics in regard to all refunds, credits, abatements, and interest allowed thereon, as submitted to the joint committee in accordance with the urgent deficiency bill, H. R. 16462, and covering the period February 28, 1927, to April 24, 1928, have been reported by Mr. W. L. Tucker, auditor for this committee. His statement on this subject is brief, but includes those facts necessary to the understanding of the situation, and it is, therefore, quoted in full:

SEPTEMBER 12, 1928.

Mr. L. H. PARKER,
Chief Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.

DEAR SIR: In accordance with your instructions, there is presented herewith a general survey of all overassessments submitted to the joint committee by the Commissioner of Internal Revenue under H. R. 16462. The appropriation provided for by the above bill was used for refundment of tax for the period February 28, 1927, to April 24, 1928. The general statistics in relation to these overassessments are first presented and are followed by a brief discussion.

STATISTICAL SUMMARY

In making a general survey of all overassessments submitted to the joint committee by the Commissioner of Internal Revenue for the period February 28, 1927, to April 24, 1928, it is first necessary to present the statistics covering these cases. Accordingly, the following figures are presented:

Overassessment cases for the period from February 28, 1927, to April 24, 1928

[Total cases, 500; monthly average, 36]

Original and additional assessments.....	\$385, 020, 734. 97	
Total tax collected.....	\$264, 783, 809. 64	
Previous allowances.....	20, 691, 144. 64	
	285, 474, 954. 28	
Overassessments.....	99, 545, 780. 69	
Barred by statute.....	1, 890, 518. 61	
Net overassessments.....		\$97, 655, 262. 08
Composed of:		
Refunds.....	55, 300, 169. 94	
Credits.....	18, 880, 113. 89	
Abatements.....	23, 474, 978. 25	
	97, 655, 262. 08	
Interest paid on overassessments.....		19, 974, 793. 36
Total of overassessments and interest.....		117, 630, 055. 44
Reduction in original tax by overassessments reported per cent..		25. 36
Average percentage of interest paid on overassessments..do....		20. 45

Classification of overassessments in re principal cause

Cases	Principal cause	Overassessment	Interest cost	Total overassessment and interest	Overassessment to total overassessments
					<i>Per cent</i>
58	Special assessment.....	\$18,440,835.19	\$4,372,772.73	\$22,813,607.92	18.88
25	Invested capital.....	11,986,467.71	2,134,210.02	14,120,677.73	12.27
31	Estate tax.....	10,913,114.28	1,481,423.46	12,394,537.74	11.18
28	Amortization.....	10,180,706.37	2,305,388.45	12,486,094.82	10.43
34	Depreciation.....	7,471,672.97	1,509,741.45	8,981,414.42	7.65
39	Affiliation.....	7,203,267.78	1,504,990.50	8,708,258.28	7.38
32	Inventory adjustments.....	6,387,807.42	1,219,450.90	7,607,258.32	6.54
17	Valuations.....	2,464,075.27	350,861.77	2,814,937.04	2.52
8	Obsolescence.....	2,089,211.46	302,450.05	2,391,661.51	2.14
8	Depletion.....	1,826,255.56	483,454.80	2,309,710.36	1.87
5	Miscellaneous court judgments.....	1,009,187.11	286,401.41	1,295,588.52	1.03
4	Gift tax.....	845,899.50	74,820.14	920,719.64	.87
4	Transfer tax.....	780,470.25	270,633.41	1,051,103.66	.80
3	Capital stock tax adjustment.....	390,163.39	85,426.05	475,589.44	.40
2	Foreign tax.....	213,562.83	20,426.30	233,989.13	.22
79	Miscellaneous.....	15,452,564.99	2,542,176.21	17,994,741.20	15.82
123	Interest recomputations (Supreme Court decision).....		1,030,165.71	1,030,165.71	-----
500	Grand total.....	97,655,262.08	19,974,793.36	117,630,055.44	100.00

ANALYSIS

The foregoing data, considered in conjunction with information contained in the files of the joint committee, discloses that during the period above-mentioned 500 cases, aggregating original and additional assessments of \$385,020,734.97, were duly reported. Of the total amount of these assessments, allowances of \$20,691,144.64 were previously made and \$264,783,809.64 of taxes were collected, making an overassessment of \$99,545,780.69, of which \$1,890,518.61 was barred from payment under the statute of limitations, resulting in net overassessments of \$97,655,262.08. The total interest cost on these overassessments amounted to \$19,974,793.36—a monthly average of 36 cases with an average overassessment of \$193,760.44. The average interest per case amounted to \$39,632.52 additional.

While the portion of the overassessments which were payable from the \$175,-000,000 appropriation consisted only of the refunds of \$55,300,169.94 plus the interest of \$19,974,793.36 or a total of \$75,274,963.30, it should be noted that the credits against taxes due amounting to \$18,880,113.89 plus the abatements of tax assessed amounting to \$23,474,978.25 or a total of \$42,355,092.14 also have a direct effect on the revenue.

CAUSES OF OVERASSESSMENTS

In order to obtain a comprehensive idea of what provisions of the law have been responsible for the large refunds already set forth, and to insure proper analysis of results, overassessments are discussed in the order in which they appear hereinafter.

1. *Special assessments.*—The special assessment provisions (sec. 210 of the 1917 act, and secs. 327 and 328 of the 1918 and 1919 acts) caused nearly one-fifth of all overassessments of tax made in the current year, notwithstanding that these provisions were repealed in 1921. It appears that the special assessment provisions are perhaps the most difficult sections ever written into the revenue acts from the standpoint of equitable administration, and the fact that no definite rules, regulations, and restrictions were adopted at their enactment, has, undoubtedly, contributed to increase the past and present difficulties with these provisions. The Board of Tax Appeals, however, has issued some decisions and rulings on this subject, and it is believed that the board will eventually formulate a definite and adequate policy.

2. *Invested capital.*—Invested capital, section 326, also ineffective since 1921, ranks second as the chief cause of overassessments, representing \$11,986,467.71 in overassessments out of a total of \$97,655,262.08, or 12.27 per cent. Evidence of the complications encountered in the determination of invested capital under this section is disclosed by the necessity, in some instances, of determining the actual cash value of property donated by stockholders, the cash value of tangible

and intangible property paid in for stock, the correct amount of depreciation sustained to date of application of the tax laws involving invested capital and the correct amount of surplus earned for prior years.

3. *Estate tax.*—Third in importance is the inheritance or estate tax, which accounts for 11.18 per cent of the total overassessments reported. A considerable portion of refunds under this section is due to the retroactive feature of the 1926 act in regard to reduction of rates. There is no doubt the evaluation of estates will always present real difficulty under present methods of appraisal.

4. *Amortization.*—Allowances for amortization resulted in overassessments of \$10,180,706.37 or 10.43 per cent of the total overassessments. Taxpayers seeking relief under this provision were engaged in the production of articles contributing to the prosecution of war. In order to meet the increased demands, plant facilities were extended, and it is upon these costs that amortization allowances are based. This provision is also one which does not affect years subsequent to 1921.

5. *Depreciation.*—The determination of depreciation allowances is the fifth major cause of overassessments. The principal difficulties encountered in these determinations are March 1, 1913, valuations and rates of depreciation. The Treasury Department has recognized this to be a question of considerable importance, and is now engaged in a scientific study with a view to arriving at definite depreciation rates for specific industries. The program has been considered by this division which concurs in the purpose of the study.

6. *Affiliation.*—The sixth important cause of overassessments lies in the application of the consolidated returns provision.

Under section 1331 of the revenue act of 1921, retroactive to the calendar year 1917, and section 240 of the revenue acts of 1918 and 1921, the filing of consolidated returns were mandatory for those taxpayers included within the category of these sections. Under subsequent acts, the filing of such returns has been optional.

The determination of whether or not companies are affiliated within the meaning of the earlier acts, has been difficult and oftentimes has led to refunds. Furthermore, many technical legal points are involved in connection with the determination of income, invested capital, gain and loss, etc., in the case of affiliated groups. Some difficulty is expected from this source even under the existing law.

7. *Inventory adjustments.*—Approximately 6.5 per cent of all overassessments were due to revised evaluations of merchandise stocks, made necessary because of the difficulty of ascertaining market prices which prevailed on specific dates.

8. *Valuations.*

9. *Obsolescence.*

10. *Depletion.*—Valuations for determining gain or loss, obsolescence and depletion are the cause for \$6,379,542.29 in overassessments, or 6.53 per cent of the total amount. All of these questions involve valuations based on judgment for which no entirely satisfactory rule has been evolved.

11. *Miscellaneous court judgments.*—As this is self-explanatory it will not be further commented upon.

12. *Gift tax.*—The overassessments in these cases are entirely due to gifts upon which assessments were made prior to the effective date of the gift tax provisions of the Revenue Act of 1924.

13. *Transfer tax.*—These cases are based on an opinion rendered by the United States Supreme Court regarding the deductibility from income of estates, of New York transfer taxes in determining the net income subject to Federal income tax.

14. *Capital stock tax adjustments.*—The capital stock tax imposed upon every domestic corporation under section 1000 of the revenue acts of 1918 and 1921 is responsible for \$390,163.39 in overassessments due principally to adjustments in the fair average value of capital stocks.

15. *Foreign tax.*—Credits allowed for income taxes paid to foreign governments in accordance with section 222 (a) revenue acts of 1921 and 1924 result in overassessments of \$213,562.83.

16. *Miscellaneous.*—This embraces 79 cases of diversified character, but is not assignable to any of the groupings of major classes listed in the tabulation following hereinafter.

17. *Interest recomputations.*—The 123 interest recomputations amounting to \$1,030,165.71 were due principally to adjustments made on which interest was computed and paid on amounts refunded from date of filing claim to the date of the schedule of overassessments in accordance with provisions of section 1324 (a) revenue act of 1921 as then interpreted. The Supreme Court, however, has con-

strued section 1324 (a) of the revenue act of 1921 to the effect that the date of allowance to which interest is payable on refunds is the date upon which the commissioner signed the schedule of refunds.

CONCLUSION

Analysis of all overassessments for the period covered by this report shows that \$86,512,447.16 of the total overassessments or 88.59 per cent were made on account of taxes in the excess profit tax years up to and including 1921, leaving a balance of \$11,142,814.92 applicable to the years subsequent thereto. This result indicates a diminution in refunds after all tax returns for the years preceding 1921 have been settled.

Respectfully submitted.

W. L. TUCKER, *Auditor.*

DISCUSSION

Some of the facts brought out in the statistics and analysis of same just presented seem worthy of brief discussion.

First, it is of general interest to note that out of a total refund appropriation of \$175,000,000, approximately \$75,000,000 went to the larger taxpayers, because this latter amount was allowed on claims in excess of \$75,000. It is also interesting to observe that the average rate of refundment in cash during the period February 28, 1927, to April 24, 1928, was approximately \$12,500,000 per month. These figures bring out the importance of tax refunds upon the net revenues of the Government.

Second, it appears that the approximate classification of these refunds and credits as to the principal cause for such allowances may be studied with profit. The fact that over 41 per cent of the overassessments are due principally to special assessment, invested capital and amortization adjustments is strikingly illustrative of the continual controversy over the income and excess-profits tax laws of the war period, for all of these provisions have been eliminated from our present revenue act and further they have had no application to any taxable year since 1921. The provisions which have caused the largest amount of refunds are the special assessment provisions, section 210 of the revenue act of 1917, and sections 327 and 328 of the revenue acts of 1918 and 1921. The application of these provisions for refund purposes is entirely within the discretion of the commissioner. (See Williamsport Wire Rope Company case before the Supreme Court which will be discussed later.) Nearly 19 per cent of all the refunds and credits, which were reported to the joint committee in the period February, 1927, to April, 1928, were allowed in whole or to a major extent by the application of this discretionary power.

In regard to those provisions of our present revenue act which would appear to be troublesome from the classification made, the following can be mentioned:

	Per cent
Estate tax (approximately)	11
Depreciation (approximately)	7½
Inventories (approximately)	6½
Miscellaneous valuation (approximately)	2½
Depletion (approximately)	2
Obsolescence (approximately)	2
Total	31½

Every one of these matters requires valuations or the exercise of expert judgment.—Unfortunately the judgment of experts has been shown to

vary over 400 per cent in not one but in many cases. It follows that constant argument prevails between the bureau and the taxpayer in the final settlement of these questions. Thirty-one and one-half per cent of all refunds reported to the committee are due primarily to adjustment on this account.

The above facts are particularly significant in the work of this committee, for it is obvious that certainty and simplicity, with the consequent elimination of dispute, will follow if valuations can be done away with to a considerable extent and some method of determining depreciation and depletion on a uniform, even if arbitrary, basis devised.

Finally, the fact that nearly 89 per cent of all the refunds and credits reported to the committee are for taxable years prior to 1922, offers the hope that with the final settlement of the excess profits tax years the annual amounts required for the repayment of taxes erroneously collected will be very substantially reduced. In our prior report on this subject (December 8, 1927), it was stated that it appeared that the peak of the refundments of tax had been reached. In view of present appropriations, that statement was plainly in error and is withdrawn. It is understood that over \$1,000,000,000 in refund claims is, at the time of writing this report, still pending before the bureau.

PART II

A STUDY OF INDIVIDUAL CASES

As pointed out in our first report on this subject, a comprehensive idea of the situation in regard to refunds, credits, and abatements can not be secured without a brief description of certain individual cases. Accordingly, a brief description will be given of the principal points involved in certain interesting cases. In the appendix will be given the pertinent documents submitted by the bureau in these cases when it appears of importance, as well as a copy of the investigation made by this division.

In connection with the description of these individual cases, some features will be frankly criticized, but it should be kept in mind, of course, that there are two sides to these questions and in many cases the final determination is extremely difficult and intricate. In fairness, it must be stated, that the great majority of these overassessment cases are on an obviously just, legal, and proper basis.

Our former report covered the examination of 323 cases; this report covers 177 cases, which represents together all the cases reported to the joint committee under the urgent deficiency bill, H. R. 16462.

In regard to the 177 cases covered by this second report, it should be stated, that 155 cases, or 88 per cent, have been clearly allowable and proper on the basis of the facts shown in the report of the commissioner to the committee.

Twenty-two cases, or 12 per cent, have seemed doubtful on the report of the commissioner and have been specially investigated through the files of the Bureau of Internal Revenue. After such special examination, 15 cases were found proper, 4 cases appeared doubtful in the opinion of the division, and 3 cases were not computed in accordance with the views of this division. Of these latter three cases, the Treasury, after considering the comments made, maintained their position in two cases and corrected the third case. The net reduction in the overassessment in this third case amounted to \$7,265.39.

A brief description and discussion of those individual cases which seem most interesting in this group will now be presented, such discussion being followed in each case by a statement of the position of the bureau with respect to our comments:

CASE NO. 1

Name and address of taxpayer: Federal Shipbuilding Co., New York City.

Figures involved

Total original and additional assessments.....	\$6, 702, 685. 16
Final tax determined.....	1, 449, 955. 57
Overassessment.....	5, 252, 729. 59
Abated.....	2, 686, 727. 93
Refunded.....	2, 566, 001. 66
Interest.....	1, 088, 501. 11

Taxable year: 1919.

Principal cause of overassessment: Amortization of war facilities.

Discussion: The only substantial cause of the refund and abatement in this case lies in the determination of amortization. The amortization section of the revenue act of 1918 was a relief provision and is in addition one of those troublesome questions dependent on the determination of a value.

The decision of the commissioner in this case is shown in Exhibit 1. The report of Mr. Chesteen, the assistant chief of this division, on his examination of the case is shown in Exhibit 2.

If these exhibits are examined it will be seen that the principal differences in the decision and the report of Mr. Chesteen concern the judgment question, What is the value in use of the war facilities?

This case was briefly before the select committee of the United States Senate on March 30, 1925. Objection was made by that committee (p. 3198 of the hearings) to the allowance of some \$200,000 in amortization on land. This amortization on land has been disallowed in the final settlement of the case.

CONCLUSION

There is no question as to the propriety of the allowance of a large amount of amortization in this case. It was the conclusion of the writer that the case was doubtful in regard to the determination of value in use, but that the determination made was within the limits of reasonableness and no positive proof could be offered in support of a lower value. *In other words, the determination is based fundamentally on judgment.*

POSITION OF THE BUREAU

Inasmuch as no question is raised as to the propriety of the refund, no comment is necessary. A discussion of the questions presented in Mr. Chesteen's report, however, is included in Exhibit 2(A).

CASE NO. 2

Name and address of taxpayer: Mr. R. A. F. Penrose, jr., Philadelphia, Pa.

Figures involved

Total original assessment.....	\$300, 731. 88
Final tax determined.....	196, 868. 56
Overassessment.....	103, 863. 32
Credited.....	50, 991. 48
Refunded.....	52, 871. 84
Interest.....	7, 216. 04

Taxable year: 1925.

Principal cause of overassessment: Recomputation of profit on sale of stock.

Discussion: On May 20, 1925, this taxpayer sold all his stock in the Utah Copper Co., for \$3,200,012.53. He computed his profit by subtracting from this amount the March 1, 1913, value or the cost of this stock as the case might be, and then further increased this profit by including therein the tax-free dividends of \$840,955.23 which he had received during the period of ownership as required by law. The reason that the taxpayer reported the dividends as tax-free

was because he deemed they were declared out of the pre March 1, 1913, earnings of the Utah Copper Co. In the case that a taxpayer receives such dividends the revenue act provides that the basis of the stock be reduced by that amount.

Now, the bureau holds that all these dividends should have been taxed when received and furthermore that the basis of the stock should not have been reduced when sold. What happens?

Why, the Government has to pay a refund of \$52,871.84 plus interest of \$7,216.04 on account of the redetermination of the profit on the sale, and finds that it should have collected for the very same reason \$191,713.57 in past years from this taxpayer which is now outlawed.

The inequity of failing to tax dividends properly taxable is bad enough, but to also allow the taxpayer to fail to reduce the basis of the stock in his hands makes the matter just twice as bad. Still this is allowed by the law, and no criticism can be made of this particular case. The bureau's remedy in this matter is as follows:

"These deficiencies (\$191,713.57) are barred from assessment, but it is proposed to write the taxpayer a letter suggesting voluntary payment."

This division is of the opinion that this remedy will be ineffective in this case and will undoubtedly be ineffective in like cases.

It is the opinion of this division that the committee should seriously consider the inclusion of a general provision in our revenue acts, providing that where there is an additional tax or a refund determined for a given year for a reason which would cause a refund or a deficiency in another taxable year which is outlawed; then the refund shall not exceed the amount by which the overpayment in the open year is in excess of the deficiency for the outlawed year; and conversely, the additional tax in the open year shall not exceed the amount by which such additional tax exceeds the refund which would have been payable for the outlawed year.

The decision of the commissioner in this case will be found in Exhibit 3, and the report of Mr. Chesteen of this division in Exhibit 4.

CONCLUSION

It appears this case has been handled in accordance with the law for 1925. Taxes have been lost in the years 1918 to 1922 in this case in the amount of over \$191,000. This is the penalty of being behind with the work.

In fairness, it should be stated, that with most of the natural resource cases open for many years, the determination of tax-free dividends has been an almost impossible task.

The writer believes it would not be overstating the proposition to say that it has been a miracle when any individual stockholder in a mining or other natural resource company has had his taxes for the early years properly determined.

POSITION OF THE BUREAU

As the bureau audit is approved, no comment appears necessary as to the propriety of the refund. With respect to the effect of the operation of the statute of limitations upon the collection of the tax liability, the position of the bureau is stated in a letter included as Exhibit 4(A).

CASE NO. 3

Name and address of taxpayer: Montana Power Co., Butte, Mont.

Figures involved

Total original assessment.....	\$847, 147. 85
Final tax determined.....	709, 719. 91
Overassessment.....	137, 427. 94
Amount of deficiency for 1923.....	11, 149. 90
Net overassessment.....	126, 278. 04
Refunded.....	126, 278. 04
Interest.....	38, 095. 86

Taxable years: 1920, 1921, 1922.

Principal cause of overassessment: Depreciation and invested capital (valuation of water rights).

Discussion: The overassessment in this case results from an additional allowance for depreciation and from a recomputation of invested capital taking into account a valuation of the physical properties, including water rights of the company and a number of subsidiaries as of the date of the merger or consolidation of these companies in December, 1912.

The rate of depreciation finally allowed is 2 per cent and as this seems reasonable, it will not be discussed further.

The interesting point in the case is connected with the valuation of water rights made by the bureau engineer. In setting a value on these rights as of December, 1912, he has not only used all the actual data and statistics up to 1923, but he has also made approximations and speculations as to what the earning power and increase in the plant and development of water rights would be up to 1942.

It has never been recognized that subsequent events should be used directly in making a retrospective valuation. The use of such data has been deemed proper in making a check of such valuation. In this case the actual data for 10 years subsequent to date of valuation was directly used. The speculations made by the engineer as to events up to 1942 seem decidedly optimistic. The actual sales of the stock of this company on the stock market do not confirm the value made.

The decision of the commissioner in this case will be found in Exhibit 5; and the reports of Mr. Chesteen, of this committee, in Exhibit 6, Part I and Part II.

Conclusion: This case is one of those in which the determination depends on a valuation based on judgment. It has already been pointed out in the first part of this report that such judgment questions are responsible for much of the trouble in arriving at proper tax determinations. In view of the methods employed in the valuation and the fact that actual stock market quotations did not confirm the value found, this division did not concur in the final determination. Nevertheless, there is nothing illegal in the determination, as the difference of opinion is on a fact question which must be determined on the evidence.

POSITION OF THE BUREAU

The position of the bureau, as stated in a letter included as Exhibit 6 (A), is:

The valuation of assets paid in for capital stock has been properly determined.

CASE NO. 4

Name and address of taxpayer: Diamond Coal & Coke Co., Pittsburgh, Pa.

Figures involved

Total original and additional assessments	\$265, 711. 24
Final tax determined by bureau	185, 820. 52
Overassessment	79, 890. 72
As revised after protest by staff of committee	72, 625. 33
Reduction in overassessment (The final overassessment was credited to 1917.)	7, 265. 39

Taxable year: 1918.

Principal cause of overassessment: Amortization.

Discussion: In the computation of amortization of war facilities, such amortization is inclusive of depreciation. In this case both amortization and depreciation were in certain cases allowed on the same facilities. This error was corrected by the bureau when it was drawn to their attention by this division. (See Exhibits 7, 8, 9, and 10 for the official documents in this case.)

Conclusion: This case is illustrative of the complicated nature of some of our income-tax adjustments. The bureau made prompt correction of the error found.

POSITION OF THE BUREAU

As the amended audit is approved, no comment by the bureau appears necessary.

CASE NO. 5

Name and address of taxpayer: Berwind-White Coal Mining Co., Philadelphia, Pa.

Figures involved

Total original assessment	\$1, 702, 350. 33
Final tax determined	924, 671. 14
Overassessment	777, 679. 19
Voluntary reductions by taxpayer on account erroneous 1918 refund	252, 105. 62
Amount refunded and abated	525, 573. 57
Refunded	374, 243. 59
Abated	151, 329. 98
Interest	171, 718. 83

Taxable years: 1919, 1920, 1921.

Principal cause of overassessment: Affiliation.

Discussion: The 1918 case of the Berwind-White Coal Mining Co. was discussed at length before the select Senate committee investigating the Bureau of Internal Revenue. The hearings on this case will be

found in Volume III of the record of this committee. Investigation was begun under date of December 1, 1924. The Commissioner of Internal Revenue caused a review to be made of this case after the investigation conducted by the select committee above referred to. The commissioner determined after this review not to make a change in the final tax liability proposed.

The final result for the year 1918 was an overassessment of \$403,435.60. This overassessment was allowed by refunding to the taxpayer in cash \$252,105.62 and crediting against 1919 taxes \$151,329.98.

It is interesting to note that in settling the 1919, 1920, and 1921 cases it is now admitted that the refunds previously made were erroneous. In fact, the taxpayer is voluntarily allowing as a credit against the refunds due to him for these years the actual cash refunds of \$252,105.62 made to him on account of the 1918 adjustment.

As a matter of fact for the year 1918 the taxpayer should have paid an additional tax of approximately \$500,000 instead of getting the refunds above noted. The statute of limitations has run against this tax, and it is only the voluntary action of the taxpayer which allows the Government now to recover the cash refund of \$252,105.62 already described.

In the 1918 adjustment the sum of \$396,625 was allowed as a loss on the sale of subsidiary company stock (Maryland Coal Co.) to a director of the company. This item was questioned in a memorandum prepared by the auditors of the Bureau of Internal Revenue, principally on the ground that it was not a bona fide sale. It now appears under the ruling of the Board of Tax Appeals in the case of H. S. Crocker & Co. that this loss was not deductible in any event.

In view of the discussion of this case before the select committee above referred to it appears unnecessary to discuss certain objections that were raised to the latter years but which are involved with questions raised for the year 1918. The decision of the commissioner in this case will be found in Exhibit 11. The letter of the writer to the Treasury Department in regard to the case will be found in Exhibit 12, the report of Mr. Chesteen of the staff of this committee will be found in Exhibit 13 and the reply of the bureau will be found in Exhibit 14.

Conclusion: This case is illustrative of one where we are obliged to make large refunds in spite of the fact that the tax in the prior year has been substantially underpaid. In regard to the particular questions raised in this case, this division is still not in agreement with the views of the bureau although it is admitted that some of the issues are rather close.

POSITION OF THE BUREAU

The position of the bureau, as stated in letters included as Exhibits 14 and 14 (A), is that the bureau audit resulting in the overassessment above indicated is proper, and more particularly, that the loss in useful value deduction has been correctly computed.

CASE NO. 6

Name and address of taxpayer: Utah Copper Co., New York City.

Figures involved

Total original and additional assessments.....	\$8, 122, 161. 40
Previous allowance.....	3, 045, 618. 59
Balance.....	5, 076, 542. 81
Final tax determined.....	4, 433, 887. 58
Overassessment.....	642, 655. 23
Portion of overassessment outlawed.....	568, 892. 74
Refunded.....	73, 762. 49
Interest.....	29, 148. 30

Taxable year: 1917.

Principal cause of overassessment: Retroactive provision of 1921 act in re gold mines.

Discussion: This case is presented as illustrative of the effect of special retroactive provisions of the revenue acts.

The revenue act of 1921 contained in section 304 (c) the following provision:

In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title or any tax imposed by Title II of the revenue act of 1917, and the tax on the remaining portion of the net income shall be the same proportion of a tax computed without the benefit of this subdivision, which such remaining portion of the net income bears to the entire net income.

The application of the above retroactive provision of the 1921 act to the Utah Copper Co.'s return for 1917 results in a refund of \$73,762.49 plus interest of \$29,148.30. The decision of the commissioner in this case will be found in Exhibit 15.

This case is a sample of certain refunds resulting from retroactive legislation.

Conclusion: In view of our previous report on refunds, it appears unnecessary to consider additional cases. The complete files are available to the members of the committee if further information is desired.

Respectfully submitted.

L. H. PARKER,
Chief, Division of Investigation.

JANUARY 18, 1929.

EXHIBIT 1

IN RE FEDERAL SHIPBUILDING COMPANY, KEARNY, N. J.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,
October 7, 1927.

MR. COMMISSIONER: A certificate of overassessment has been prepared in this case for the year 1919, in the amount of \$5,252,729.59. This corporation was a subsidiary of the United States Steel Corporation but was excluded from consolidation under section 240 (a) of the revenue act of 1918, because over 50 per cent of its gross income was from Government contracts made after April 6, 1917, and prior to November 11, 1918.

In the completed return filed May 15, 1920, for 1919, a deduction of \$3,610,721.54 was taken for amortization of war facilities, and upon the resultant net income of \$8,486,770.12, a tax of \$6,702,685.16 was assessed. With the return was filed an abatement claim in the sum of \$2,686,727.83, in which it was explained

that the amortization deduction taken of \$3,610,721.54 represented 25 per cent of the cost of the war facilities, in accordance with article 184 (3) of Regulations 45 (edition approved April 17, 1919), as amended by T. D. 2859, whereas it claimed amortization in the amount of 50 per cent of cost, or a total of \$7,221,443.07. On March 27, 1924, the taxpayer filed a claim for refund of \$2,384,077.57, for the years 1918 and 1919, in part including exceptions to an audit letter dated February 14, 1924, proposing an additional tax of \$51,252.40 for 1918. In this claim a request was made that the net income be determined upon the basis of completed contracts, under article 36, Regulations 45 and 62; that the aggregate amortization allowance be \$10,845,523.45; that the taxpayer be allowed a deduction of \$5,432.68 for 1918 and \$21,832.55 for special compensation to employees; and it was asserted that a revenue agent had allowed for 1919 an excessive amount of depreciation of \$142.82 but an insufficient amount for transportation tax deduction of \$1,450.50. A further claim for refund was filed for \$4,015,957.33, on March 15, 1926, asking amortization allowance of \$12,454,171.06.

This corporation was organized July 21, 1917, by the United States Steel Corporation, as a subsidiary, for the purpose of building a shipbuilding plant to enable it to construct steel ships for the Emergency Fleet Corporation. It took over a tract of 156.81 acres of land (in conference here stated to have been owned by the American Bridge Co.), on the west bank of the Hackensack River, near its confluence with the Passaic River, and purchased a tract of 95.82 acres on the east bank. The large area was designed to be a site for the shipways and attendant shops, while the other tract was intended to serve both as a protection for

launching vessels and as a site for future expansion of dry dock and repair facilities. No development apparently took place on this east tract.

It was intended to construct 10 shipways at this yard. Construction of the plant began at once, work on the shipways on August 10, 1917, and a contract was made with the Emergency Fleet Corporation for the building of 10 steel cargo ships of approximately 10,000 deadweight tons each, the first keel being laid on November 15, 1917. Subsequently another contract was made for the construction of 20 more steel vessels of similar type, and two more shipways were constructed. Three of the 30 ships were completed in 1918 and the rest in 1919.

The bureau made a field investigation of the amortization claim, and the report, dated October 16, 1922, recommended allowance of \$9,624,866.48 on 1917, 1918, and 1919 costs aggregating \$16,745,147.36. This report set up postwar replacement values by using established ratios applied to June 30, 1916 costs, and for facilities retained in use, applied generally a percentage of 66% per cent as value in use, based upon the ratio of average postwar production to normal capacity, after taking into consideration the taxpayer's abandonment of six shipways. Salvage values were used on abandoned facilities. Among other items, amortization was allowed on plant sites and an amount of \$293,756.58 on costs of transferring certain water-supply pipes to the city of Bayonne, hereafter discussed.

Under date of December 28, 1922, the taxpayer filed a letter asking revision of the amortization allowance upon the grounds that the actual production figures for 1922 should be substituted for the prior estimates, and that the 1923 estimates should be revised. It was requested that the postwar value in use percentage be reduced from 66% to 53.32 per cent. On March 31, 1923, the company filed a brief of exceptions to the report of October 16, 1922, asking use of revised estimates of production in the postwar period, and also criticising the basic costs used previously by the Bureau's agents in determining replacement costs, and in some cases, the method of fixing the value in use.

A revised amortization report was submitted, under date of May 7, 1923, in which the value in use "factor" was reduced to 53.31 per cent, and other changes were made on sundry facilities, so that the allowance was recommended of \$10,788,109.26 on 1917, 1918, and 1919 costs aggregating \$16,745,147.36, after deduction of \$283,020.68 "contractual amortization" received in 1922. After the case had been considered in the Audit Section of the Bureau, and in considering the refund claim and brief filed in March, 1924, it was decided to have the amortization allowance reviewed and a redetermination was instituted on January 5, 1925, the case being referred to the engineering division. The amortization was then reconsidered, under the rulings made in S. M. 4225, IV-2 C. B. 168, resulting in a revised report dated October 28, 1926. A revised claim had been filed on March 15, 1926, claiming an aggregate allowance of \$12,454,171.06.

In this report war time normal capacity was compared with normal postwar use, for facilities retained in use, mostly figured in hours, but in some cases, in tonnage and number of employees. The use ratio was found to be about 30 per cent. No amortization was allowed on land and land improvements, and none was allowed on the transfer of the Bayonne pipe lines, upon the ground that the latter was not a facility acquired by the taxpayer. On facilities sold it was possible to fix definite losses. This report recommended allowance of \$10,747,-350.74 on 1917, 1918, and 1919 costs of \$14,774,283.23. Based upon this report, a certificate of overassessment was prepared, but under recommendation from the general counsel, in a memorandum dated May 26, 1927, the case was reconsidered, in the light of the decision in the case of Manville Jenckes Co., 4 B. T. A. 765, with particular reference to the comparison of maximum war-time capacity with maximum postwar production. A revised report was prepared, under date of July 16, 1927, in which amortization was recommended in the amount of \$10,817,735.27, on 1917, 1918, and 1919 costs of \$14,779-783.23. No allowance was made on land and none on the Bayonne water-pipe transfer. The year 1921 was adopted as the year of maximum postwar production, although alleged by the taxpayer to have been an abnormally large year, and although some departments showed a greater activity in 1922 or 1923 than in 1921.

In view of the various examinations and audits made at the premises, the admitted abandonment of 6 of the 12 shipways, and the well-known state of post-war depression in the shipbuilding industry, it is recommended that the amortization allowance be approved. By reason of the completion of most of the war work in 1919, that year shows the maximum war-time capacity, and, too, all the amortization allowance is allocated to 1919, because no income was realized in 1918 from amortizable facilities.

Depreciation is disallowed for 1919 on amortized facilities, also loss on abandoned facilities, in the aggregate amount of \$1,094,031.81. Sundry small deductions are allowed, such as special compensation accrued to employees in 1919.

The only other adjustment of major importance is the allowance of a deduction from gross income of \$261,097.27, representing the cost (applicable to 1919) of transferring the Bayonne water pipes, above mentioned. It appears that when the taxpayer acquired the two tracts on the Hackensack River, each was traversed by two 30-inch water mains serving the city of Bayonne. In 1918 these mains were assigned by a private owner to the municipality of Bayonne. The taxpayer designed to use water from these mains, and did so. Owing to leakage and increased demands for water imposed by adjacent plants representing war developments, the city of Bayonne proposed to add another main, 48 inches in diameter. After the taxpayer had, at the request of the Emergency Fleet Corporation, begun construction of shipways Nos. 11 and 12, at the north end of the yard, it was felt that there was grave danger of breaking the two existing mains where they passed under the river, from prospective launchings from these ways. The two mains were apparently at no great depth.

In order to avoid such dangers, and in order to relieve the yard from the burdens of these important mains traversing its yard, the taxpayer agreed to contribute a sum of money to help defray the expense of transferring the two existing mains to a course along part of the north boundary of the yard site and along the north and east side of the east-bank tract. The expense of the company in 1919 amounted to \$261,097.27. It is readily apparent that the removal of the risk of breaking a city's water supply, particularly in the years 1918 and 1919, was a direct benefit to the operations of this taxpayer, and while it is possible that the fee might have been permanently enhanced in value by the transfer of this easement, the lasting benefit, indefinite in amount, was far outweighed by the temporary gain, and the deduction has been allowed as a business expense in 1919.

In view of the foregoing, it is recommended that the overassessment be allowed.

A. W. GREGG,

General Counsel, Bureau of Internal Revenue.

Approved: October 8, 1927.

D. H. BLAIR,

Commissioner of Internal Revenue.

EXHIBIT 2

IN RE FEDERAL SHIPBUILDING CO., NEW YORK CITY

JANUARY 3, 1928.

Mr. L. H. PARKER, *Chief,*
Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund in the case of the above-named taxpayer for the taxable year 1919. The results of this examination are set forth below:

HISTORY

The Federal Shipbuilding Co., a subsidiary of the United States Steel Corporation, was organized in July, 1917, the entire capital stock being paid in by the parent company. A plant site was acquired near the confluence of the Hackensack and Passaic Rivers, N. J., on which was constructed a shipbuilding plant having a capacity of twelve shipways. A contract with the United States Government was secured for the construction of ships, and, during the years 1918 and 1919, a total of 34 ships was completed and delivered, all the income from which has been included in the return for the calendar year 1919.

The taxpayer, in its return for the calendar year 1919, deducted amortization in the amount of \$3,610,721.54, resulting in a tax of \$6,702,638.16. Subsequently claim for amortization was made, based upon amended schedules, totaling \$12,084,402.34. The latter claim was examined by Engineers H. A. Whitney and C. B. Watkins, under date of October 16, 1922, resulting in an allowance of \$9,680,077.82. This determination was based upon value in use of property retained and salvaged or sales value of property discarded and sold. In determining value in use, it was necessary for these engineers to estimate, of course, the value in use for the remaining postwar period, and where facilities retained at that time were thought to be needed in the taxpayer's postwar business to the extent of the capacity of the facilities, the allowance for amortization was based upon postwar replacement cost.

The report made by these engineers apparently was not acceptable either to the bureau or to the taxpayer, and the bureau thereupon proceeded to make a redetermination of the amortization allowance. The first of these redeterminations was made by W. S. Tandrow, under date of October 28, 1926. The report apparently was prepared under the instructions of the office of general counsel, as outlined in Solicitor's Memorandum 4225, Bulletin 43, Volume IV, dated October 26, 1925. Before action was taken, however, on the allowance recommended in this report, the United States Board of Tax Appeals rendered a decision in the case of the Manville Jenckes Spinning Co., Volume IV, page 765. The refund now proposed in this case is based upon the report of the above-named engineer and is purported to be in accordance with the latter decision.

FINDING OF FACTS

The allowance made in this case is based upon two classes of property: First, property sold or discarded; second, property retained in use. The allowance on property discarded or sold is based upon the selling price or the estimated salvage value. The allowance for amortization on property retained in use has been made somewhat as follows:

The year 1921 has been determined to be the postwar year in which the taxpayers' plant, as a whole, during the postwar period, operated at its greatest per cent of capacity. This year then is selected as the big year of postwar operations. The capacity of each class of facility has been determined either from demonstrated capacity or from estimated capacity, and the ratio of the actual operations during 1921 to the demonstrated or estimated capacity of the facility has been used in determining the value in use. The classes of facilities and the residual values established are as follows:

Group	Facility	Cost	Residual ratio	Amortization recommended
			<i>Per cent</i>	
I-A	Cafeteria.....	\$2,249.87	100.00	-----
I	Mold loft equipment.....	5,325.80	10.12	\$4,786.83
II	Fitting out basin.....	400,092.22	38.28	246,936.92
III	Joiner shop equipment.....	47,652.80	18.76	38,713.13
IV	Machinery and equipment.....	904,915.79	34.58	591,995.91
V	Plate shop building.....	1,159,013.71	25.54	863,001.61
VI	Plate yard facilities.....	203,943.12	23.09	156,852.65
VII	Plate shop machinery.....	806,142.63	23.08	620,084.91
VII	do.....	53,816.26	23.08	41,395.47
VII	Shop cranes.....	40,640.61	23.09	31,256.69
VIII	Forge shop building.....	308,975.78	28.09	237,633.27
IX	Forge shop machinery.....	258,046.67	21.41	202,798.88
X	Shipways.....	1,840,477.83	45.33	1,006,189.23
XI	Pattern shop equipment.....	12,751.82	33.07	8,534.79
XII	Machine shop building.....	805,333.67	33.90	532,325.56
XIII	Boiler shop and equipment.....	1,425,086.72	-----	-----
	Contractual amortization.....	255,247.04	-----	-----
	Reduced cost.....	1,169,839.68	10.99	1,013,222.65
XIV	Carpenter shop.....	177,725.36	63.80	64,336.58
XV	Rigging loft.....	74,864.64	37.79	46,573.29
XVI	Metal shop building.....	93,864.81	50.29	46,660.20
XVII	Metal shop machinery.....	77,620.27	50.29	38,535.33
XVII	Welding shop building.....	23,153.71	43.16	13,160.57
XVIII	Welding shop equipment.....	45,387.09	46.44	24,309.33
XX	General plant facilities.....	459,900.21	30.60	319,170.75
XX	Heating plant.....	68,160.77	30.60	47,303.57
XX	Unloading dock.....	34,614.97	30.60	24,022.79
XX	Hospital.....	46,953.35	30.60	32,585.62
XX	Cold storage.....	752.25	30.60	522.06
XX	Trolley loop.....	14,701.54	30.60	10,202.87
XX	Office building.....	577,309.93	30.60	400,653.09
XX	Stores building.....	266,797.56	30.60	185,157.51
XX	Steel storage.....	1,105.65	30.60	757.32
XX	Miscellaneous structures.....	43,182.66	30.60	29,968.77
XX	Paint shop.....	33,779.36	30.60	23,442.83
XX	Outfitting shop.....	25,128.10	30.60	17,438.90
XX	Track system.....	337,891.78	30.60	234,496.90
XX	Power plant.....	911,091.42	30.60	632,297.45
	Total.....	11,650,130.95	-----	8,007,351.20

OPINION

The allowance made in this case appears excessive for the following reasons:

(1) The determination of the allowance has been based solely upon value in use of the property, the value, in most instances, approaching a salvage value for the equipment retained in use;

(2) The value in use has been determined upon the number of man-hours of each item of equipment rather than upon the basis of the operation of the plant as a whole; and

(3) No account has been taken of the value of this plant as an important branch of the parent company, namely, the United States Steel Corporation.

From the facts thus far, it seems clear that this plant was not only established for war purposes, but that it was established as a permanent unit of the parent company and that as such it was contemplated that in postwar years this unit would serve as an outlet for the use of the parent's products which through the operations of the subsidiary, might be converted into substantial profits.

VALUE IN USE AS A BASIS FOR AMORTIZATION ALLOWANCE

The United States Board of Tax Appeals, in the case of the Standard Refractories Co., Docket Nos. 3617 and 3618, promulgated February 3, 1927, in considering this question, said:

"* * * If we assume that the physical use to which the amortizable facilities were put in the normal peace-time business was but 51.74 per cent of their use during the war period, it does not necessarily follow that the value of these facilities to the petitioner is but 51.74 per cent of their original cost. Undoubtedly this is a factor which should be considered in determining what amount should be allowed as a reasonable deduction for amortization, but at best it is but one of the several factors. The cost of replacement, during the postwar

period, of the same or other facilities which would produce the same results; any improvements or radical changes in the facilities; the salvage value of such facilities; their selling price if they have been sold; a proper discount for excess facilities which may be used because they are on hand but which in the ordinary conduct of the business would have been acquired only in the future; and all other similar factors, depending upon the facts in the particular case, must be considered in determining the amount of the deduction."

It is, therefore, the opinion of the writer that inasmuch as the actual value in use approaches a salvage value on facilities, many of which have a somewhat high replacement cost, consideration should have been given in this case to the cost of replacement during the postwar period of the same or other facilities which might have been needed for the taxpayer's postwar business. An example of the discrepancy between the value in use as determined and the postwar replacement cost of similar facilities is best shown by a comparison of a few items set forth in the report of Engineer H. A. Whitney with the amounts allowed by Engineer Tandrow.

PLATE SHOP

The taxpayer in its claim contended that it did not need for postwar business a plant in excess of six shipways and, on the basis of a six shipway maximum capacity, computed the postwar replacement cost of the facilities retained in use. The plate shop originally cost \$1,162,869.40. In the taxpayer's claim a replacement cost of \$901,911.60 is shown. Engineer Whitney determined the \$1,162,869.40 and recommended amortization based upon the reduced value in use of 33½ per cent of this amount, or a total of \$387,623.14. His comments are as follows:

"The plate shop is a structural steel building three bays in width on the ground floor, namely, 63 feet, 63 feet, and 48 feet in the center. Its length consists of twenty 40 feet bays, making a total length of 800 feet. The first floor of this shop is used as a plate and angle shop. The building for its entire length is two stories high over the first two bays, the second floor being used as a pattern and joiner shop and as a mold loft. This shop does not have sufficient capacity to turn out work required for a 12-way yard under normal operations. When the yard was built a large percentage of the structural steel work for the hulls, which under normal conditions would be fabricated in the plate shop, was purchased in fabricated form. For this reason the plate shop was never constructed to balance a 12-way shipyard but is suitable for a 6-way yard.

"The taxpayer does not claim reduction in size of the plate shop due to reduction in size of the yard. * * *"

Engineer Tandrow, in the allowance recommended, computes the amortization as follows:

Cost of plate shop building	\$1, 159, 013. 71
Residual value (per cent)	25. 54
Amortization recommended	863, 001. 61

His comments are as follows:

"In the prior report the value in use of the plate shop building was based upon performance during 1919. Capacity was stated to amount to 1,533,699 productive labor hours. In the brief dated June 23, 1927, the taxpayer claimed a capacity amounting to 2,044,368 labor hours. An analysis of monthly operating statistics will not justify the allowance of the maximum capacity in excess of the labor hours stated in the former report. The amortization allowance on plate shop facilities will be determined accordingly."

Capacity labor hours	1, 533, 699
Postwar comparative (1921 labor hours)	391, 650
Value in use ratio (per cent)	25. 54

BOILER SHOP

The total cost of boiler shop equipment is \$1,425,086.72. The United States Government allowed contractual amortization to the extent of \$255,247.04, making a net cost borne by the taxpayer of \$1,169,839.68. Engineer Whitney determined a postwar replacement cost of \$1,215,379.81. The building and equipment, however, were constructed for a twelve-way plant, and, inasmuch as the taxpayer claimed his postwar business required only a six-way plant, the engineer allowed a value in use of \$446,116.71. Engineer Tandrow, on the same facilities, recommends an amortization of \$1,013,222.65, resulting in a residual value of 10 per cent of the cost borne by the taxpayer, which gives a residual value of \$116,983.97, or approximately 8 per cent of the original cost of the facilities.

Numerous other items of substantial amounts in this report might be contrasted with the replacement cost and value in use shown by the previous engineer, but the two items above indicate the general trend of the discrepancy between the reports. In view of the decision of the United States Board of Tax Appeals in the case of Standard Refractories Co., the method of arriving at amortization, as indicated by the two items above, certainly is open to question. The operation of the plant as a whole, as shown by the reports of the engineers mentioned above, is approximately 45 per cent, this ratio, of course, being based upon the highest postwar year to maximum capacity for a 6-way plant. A determination of the amortization on facilities retained in use by this method would be as follows:

Cost of property retained in use, less residual value of property retained in use=45 per cent of \$11,650,130.95-----	\$5, 242, 558. 92
Correct amount of amortization-----	6, 407, 572. 03
Amount recommended by engineer-----	8, 007, 351. 20
Apparent overstatement-----	1, 599, 779. 17

Engineer Tandrow, in determining the value in use on the basis of man-hours of each item of equipment, cites the decision of the United States Board of Tax Appeals in the case of the Manville Jenckes Spinning Co. In the case of the Manville Jenckes Spinning Co., the activity of the taxpayer consisted of two major operations, namely, weaving and spinning. The board, in determining the value in use, used the ratio indicated by the capacity of the weaving and spinning facilities in pounds of products used in the highest postwar year to the maximum capacity of these facilities in pounds. It is submitted that, in the instant case, the best measure of postwar activity is tonnage of ships completed. Decisions of the Board of Tax Appeals would seem to sustain a computation based upon this principle.

As a further contrast to the principle enunciated by the board in the Manville Jenckes Spinning Co. case are similar computations made in this case. For example, on page 25, Item (12)—machine shop building—a maximum capacity has been determined of 760,000 man-hours; 1921, as previously stated, has been selected as the maximum postwar year. The total number of postwar comparative productive labor hours is 448,850, but the number used by the engineer in determining the value in use ratio is 257,665.

On pages 19 and 20 the joiner shop is determined to have a maximum capacity of 750,000 productive labor-hours. During the year 1923, these same facilities showed productive labor hours of 352,144, yet the engineer uses, for a postwar comparative, productive labor hours of 140,670, which is the number of productive labor hours during the year 1921.

It would seem that if each facility is to have its postwar value in use determined upon the basis of its value in use, computed on the basis of the number of productive labor hours, the principle of the Manville Jenckes Spinning Co. case would require that the maximum productive labor hours during any one of the postwar years should have been used.

VALUE OF THIS PLANT TO THE PARENT COMPANY

It is not possible, of course, from a review of this case, to determine whether or not this factor, if considered, would have shown different results. This case was talked over in a general way with Mr. J. M. Clack, chief of the appraisal section, who approved this report. Mr. Clack himself admitted that this factor was not considered in determining the amortization.

The results in this case speak for themselves. The taxpayer closes his war activity with a modern shipbuilding plant having a capacity of six shipways, or approximately 140,000 ship-tons. Residual value computed by the engineers on this plant, including the land, is \$3,962,047.96. The auditors have allowed a further reduction of this figure in the amount of \$261,000, reducing the cost to the taxpayer to approximately \$3,700,000 for the land and all the buildings and equipment. Such a low value on property situated as the property in this case is, and with the admissions, at least, by the first engineer, that this company is in an extremely advantageous position to get its portion of competitive business, and, in addition, to the value that might attach to it as an important unit of the United States Steel Corporation, the allowance appears open to criticism. It is generally recognized that the shipbuilding industry is in the throes of a slump

as the result of overproduction during the war. There seems to be no thought of the taxpayer scrapping his plant, and it is only a matter of time until it will undoubtedly be a profit making business.

Engineer Whitney commented on the position of the taxpayer as follows:

"The engineers consider that owing to the location of the plant in question, the chances of getting work are favorable, and, due to the low price for which ships can be manufactured by the taxpayer, it can successfully bid against competition."

The above findings are submitted to you for your consideration and as a matter of record in this case. The refund proposed is more than \$5,000,000, or approximately 85 per cent of the tax originally paid. The case has been in controversy for a long period of years.

There is one situation, however, which I deem it necessary to call your attention to in this case and that is the prolongation of the period of controversy with respect to amortization. Even a superficial examination of the case would have disclosed to anyone that a refund in this case was necessary. In such a case, had an immediate and thorough examination been made of the amortization allowance, a substantial saving to the United States Government could have been effected in the way of interest. For example, this case was first assigned to engineers in 1922, or five years ago. It was obvious, at that time, that a refund was due the taxpayer, the only question being the amount of the refund. Had a speedy determination been made at that time, several hundred thousand dollars in interest might have been saved in the case.

Respectfully submitted.

G. D. CHESTEEN,
Corporation Auditor.

EXHIBIT 2(A)

IN RE FEDERAL SHIPBUILDING CO., NEW YORK, N. Y.

TREASURY DEPARTMENT,
Washington, June 18, 1929.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: I am transmitting herewith a memorandum from the general counsel with reference to Mr. Chesteen's report to you in the above case.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

JUNE 18, 1929.

Mr. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury:

Reference is made to comments of Mr. G. D. Chesteen relative to the above indicated case as set forth in his letter to Mr. L. H. Parker, published as Exhibit 2 of the second report on refunds, credits, and abatements under the urgent deficiency bill, H. R. 16462.

The first point made by Mr. Chesteen seems to be that the allowance for amortization as found by the bureau was excessive, since it was based solely on value in use of the amortized facilities. Article 184 of Regulations 62 provides that: "(2) In the case of property not included in (1) above (i. e., where the property has not been sold or permanently discarded), the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business, such value to be not less than the sale or salvage value of the property and not greater than the estimated cost of replacement under normal postwar conditions less depreciation and depletion."

The effect of the regulation is that after a determination of postwar value in use to a taxpayer with respect to facilities acquired for war purposes, the value in use so found shall be deducted from war costs less depreciation thereof to January 1, 1918, in determining the amount of amortization to which the taxpayer is entitled as a deduction from gross income. The regulation further provides, however, that if the sale or salvage value of the same facilities is greater than the value in use to the taxpayer then such sale or salvage value shall be used as a basis in determining the amount of amortization sustained on the war facilities.

This is on the theory the taxpayer can not sustain a loss on the purchase of war facilities by an amount greater than the difference between cost less depreciation to January 1, 1918, and the price for which the facilities could be sold, which theory is believed to be entirely sound and reasonable. The regulation also provides that if postwar replacement cost of the same facilities is less than the value in use to the taxpayer, such postwar replacement cost shall be used as the basis in measuring the amount of the amortization deduction to which the taxpayer is entitled. This is on the theory that although the taxpayer may be using its facilities to, say, 50 per cent of capacity, nevertheless, if, after the war, it can replace them for 25 per cent of war cost, then such replacement cost should be used in measuring the loss, which also seems to be entirely sound and reasonable.

The effect of Mr. Chesteen's argument seems to be that postwar replacement cost should also be used to decrease as well as increase the amortization allowance. In other words, if a war facility cost \$1,000 and its postwar replacement cost was \$1,200 no amortization should be allowed even though the facility may have been of no value in use to the taxpayer during the postwar period. It is not seen how such a test could reasonably establish the loss sustained through the purchase of facilities for war purposes. The mere fact that replacement cost exceeds actual war cost or is greater than value in use to the taxpayer does not necessarily mean that the taxpayer has sustained no loss on its war purchase, since, due to the nature of the facility, it may have little or no sale or salvage value or postwar useful value to the taxpayer. It is of course admitted that in so far as postwar replacement cost increases the sale or salvage value that it will serve to decrease the amortization allowance. This is specifically provided for in the departmental regulations, under which the present case is adjusted, as may be seen from the provisions of article 184 (2) to the effect that value in use to the taxpayer is not to be considered less than the sale or salvage value of the property.

Mr. Chesteen cites the decision of the board in the case of Standard Refractories Co., 6 B. T. A. 24, as possibly supporting his view that where replacement cost is higher than value in use to the taxpayer or sale or salvage value it should be used to decrease the amortization allowance. In this case the board was asked to find the amount of useful value to the taxpayer based upon a comparison of pre-war and war production with postwar production for the brief period up to October, 1922, at which time the petitioner's stock was acquired by another company. There was no proof of the other necessary elements required by the bureau such as sale or salvage value, replacement cost, improvements in the facilities used after the war, the purchase price paid for the petitioner's stock, and in the absence of proof concerning these necessary elements the bureau denied the taxpayer's claim. The board also denied the claim for the same reasons. Among other things replacement cost was undoubtedly a desirable element in judging the proper amount of the allowable amortization since if for no other reason this would have been desirable in judging the sale or salvage value. It is believed, though, that the board's reference to the fact that among other things postwar replacement cost was missing is far from a holding by the board that if replacement cost is greater than value in use or sale or salvage value it must be used as a basis to reduce the amortization allowance.

In the present case the amortization allowance was based on article 184 of Regulations 45 and 62, which has been in effect for a number of years and which has been followed by the board so far as the present point is concerned in a number of cases such as Appeal of Banna Manufacturing Co., 1 B. T. A. 1037, Manville Jenckes Co., 4 B. T. A. 765, and Standifer Construction Co., 4 B. T. A. 525. It is not believed that the board's decision in the Standard Refractories Co. case, *supra* (which sustains the bureau's position), is sufficient authority to amend the regulations or affect the result reached under the regulations in the instant case.

Mr. Chesteen also contends that the value in use of the amortized facilities in each department is more correctly represented by the activity of the yard as a whole, as shown by the tonnage of ships built, than by a comparison of the production of each department with the capacity of that individual department. Since the war period, the taxpayer in an endeavor to keep the yard in operation has undertaken several different forms of industry other than shipbuilding, which have at different periods increased the activity of one or more of the different departments. It is not seen why this additional activity should not be used in measuring value in use of the facilities. If the allowance were based entirely upon tonnage of ships built, and the other activities during the postwar period not given effect, the amortization allowance would have been substantially greater than the amount recommended. In this connection Mr. Chesteen states that

value in use of the plant as a whole is 45 per cent of the capacity of a yard of six building ways. It is not seen how it would follow from this statement that the plant as a whole was operated to 45 per cent of capacity of the six ways if this conclusion was intended. The yard was built with a capacity for 12 ways, and although 6 of those ways have been abandoned the remainder of the departments are still of 12-way capacity; consequently with the exception of the ways themselves, it would seem to be clearly improper to base value in use of other departments upon a 6-way capacity.

Criticism also seems to be made to the effect that value in use of the facilities in each department should be based on a comparison of the capacity of the individual departments with maximum annual production of that department during the postwar period, instead of comparing the capacity of each department with production of the year in which maximum annual production of the yard as a whole was obtained. This view does not seem to be consistent with Mr. Chesteen's previous criticism that value in use should have been based upon operation of the yard as a whole. The action taken by the unit was based upon the fact that the facilities in the several departments of the yard, if viewed from any other standpoint than as forming a part of the yard as a whole, would have even lower values than those recommended. If value in use is to be based upon maximum annual production, it would be inconsistent to determine such values upon any other basis than production of each department for the year during which the yard as a whole reached its maximum activity.

Mr. Chesteen seems to contend that in the determination of the residual value of the amortized facilities the value of the property to the other properties of the United States Steel Corporation was not given proper effect. There appears to be some misunderstanding regarding this question, since it also was fully considered and a decision reached that no basis existed either under the law or the regulations for increasing the value of the facilities (above value in use or sale value) because of the fact that operation of the facility might increase the value of the other properties of the Steel Corporation. Furthermore, there was not found to be any ground for assuming that the operation of the Federal Shipbuilding Yard had any effect upon the value of the taxpayer's other properties; and, since such production of the other plants which resulted from operation of the Federal Shipbuilding Yard obviously increased the value in use of those facilities and reduced the amortization otherwise allowable on those properties, to have again reduced the amortization allowance on the Federal Shipbuilding Yard for the same reason would have clearly resulted in a duplication.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

EXHIBIT 3

IN RE MR. R. A. F. PENROSE, JR., PHILADELPHIA, PA.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,
November 11, 1927.

MR. COMMISSIONER: A certificate of overassessment has been prepared by the unit in favor of the above-named taxpayer in the amount of \$103,863.32 for the year 1925.

Prior to March 1, 1913, the taxpayer was a stockholder in the Utah Copper Co. On that date he held 32,202 shares of its stock, then valued at \$53.20 a share. In April, 1923, he acquired, by bequest, 1,662 additional shares, then valued at \$74 a share. The company made distributions to its stockholders from time to time during the period from June, 1917, to March, 1925. On May 20, 1925, the taxpayer sold all his stock in the company consisting of 33,864 shares (32,202 plus 1,662) for \$3,200,012.52. In computing his profit on the sale of his stock the taxpayer erroneously concluded that the distributions made by the company from time to time constituted a return of capital. The distributions were not reported by him as income when received but on the theory that they constituted return of capital, they were applied at time of sale to reduce the March 1, 1913, value, with a corresponding increase in capital net gain realized from the sale. On his return for 1925 the taxpayer computed his capital net gain from the sale on that basis, with the following result, viz:

Sale price of 33,864 shares of stock.....	\$3, 200, 012. 53
March 1, 1913, value of 32,202 shares.....	\$1, 722, 807. 00
April 1, 1923, value of 1,662 shares.....	122, 988. 00
Total value.....	1, 845, 759. 00
Distributions on original holdings.....	840, 955. 23
	1, 004, 839. 77
Distributions on acquired holdings.....	12, 057. 81
Net value as computed by taxpayer.....	992, 781. 96

Capital net gain as reported on 1925 return..... 2, 207, 230. 57

Under well-established rulings of the department (art. 1541, Regulations 69) the distributions made by the company should have been considered by the taxpayer as income and taxes paid accordingly. The distributions constituting income, the capital net gain received on the sale of the stock has been recomputed with the following result, viz:

Sale price of 33,864 shares of stock.....	\$3, 200, 012. 53
Mar. 1, 1913, value of 32,202 shares.....	\$1, 722, 807. 00
April, 1923, value of 1,662 shares.....	122, 988. 00
	1, 845, 795. 00

Revised capital net gain..... 1, 354, 217. 53

The corrected net capital gain on the transaction is thus the difference between \$2,207,230.57, as reported by the taxpayer, and \$1,354,217.53 as computed by the bureau, namely, \$853,013.04. On that basis there was an overassessment for 1925 in the sum of \$106,626.63.

As a result of the recomputation, the distributions received by the taxpayer have been spread over the years 1918 to 1925, the years when received but not reported, with the following results:

Deficiency in tax

1918.....	\$45, 646. 33
1919.....	82, 887. 38
1921.....	36, 195. 84
1922.....	26, 984. 02
Total deficiencies.....	191, 713. 57
1920.....	\$45, 442. 83
1923.....	41, 073. 15
Total deficiencies.....	2 86, 515. 98
1924.....	3 43, 670. 92

The overassessment for 1925 of \$106,626.63, as indicated above, has been reduced to the sum of \$103,863.32 by including in the taxpayer's income for that year the sum of \$13,816.51, representing dividend income received but not included in the return for that year.

It is recommended that the overassessment in the amount of \$103,863.32 be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved November 11, 1927.

D. H. BLAIR,
Commissioner of Internal Revenue.

¹ These deficiencies are barred from assessment, but it is proposed to write the taxpayer a letter suggesting voluntary payment.

² These taxes were actually assessed and have been paid.

³ This amount has not been assessed, but it is proposed to suggest to the taxpayer that he waive his right to file a petition with the Board of Tax Appeals and consent to the assessment and collection of the tax.

EXHIBIT 4

IN RE R. A. F. PENROSE, JR., PHILADELPHIA, PA.

FEBRUARY 18, 1928.

Mr. L. H. PARKER,
*Chief, Division of Investigation,
 Joint Committee on Internal Revenue Taxation,
 House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above-named individual, for the year 1925, totaling \$103,863.32, with special reference to the manner of computation of profit on the sale of stock of the Utah Copper Co. The results of this examination are as follows:

FACTS

The above-named individual acquired stock in the Utah Copper Co. in the following amounts:

	Shares
By original purchase prior to Mar. 1, 1913.....	32, 202
By bequest in April, 1923	1, 662

The entire amount of stock was sold in the year 1925 for a total sale price of \$3,200,012.53. The taxpayer computed the profit upon the sale of the stock as follows:

Sale price of 33,864 shares of stock.....	\$3, 200, 012. 53
Mar. 1, 1913, value of 32,202 shares.....	\$1, 722, 807. 00
Apr. 1, 1913, value of 1,662 shares.....	122, 988. 00
Total value.....	1, 845, 759. 00
Distributions on original holdings.....	840, 955. 23
	1, 004, 839. 77
Distributions on acquired holdings.....	12, 057. 81
Net value as computed by taxpayer.....	992, 781. 96

Capital net gain as reported on 1925 return..... 2, 207, 230. 57

Under the provisions of article 1541, Regulations 69, the distributions previously treated by the taxpayer as return of capital have now been determined to be income in the year in which received. The profit on the March 1, 1913, value of the stock has thus been determined as follows:

Sale price of 33,864 shares of stock.....	\$3, 200, 012. 53
Mar. 1, 1913, value of 32,202 shares.....	\$1, 722, 807. 00
April, 1923, value of 1,662 shares.....	122, 988. 00
	1, 845, 795. 00
Revised capital net gain.....	1, 354, 217. 53

The result of the bureau's treatment has been to produce additional tax in the years 1918 to 1924, as follows:

	Deficiency in tax
1918.....	\$45, 646. 33
1919.....	82, 887. 38
1921.....	36, 195. 84
1922.....	26, 984. 02
Total deficiencies.....	¹ 191, 713. 57
1920.....	45, 442. 83
1923.....	41, 073. 15
Total deficiencies.....	² 86, 515. 98
1924.....	³ 43, 670. 92

¹ These deficiencies are barred from assessment, but it is proposed to write the taxpayer a letter suggesting voluntary payment.

² These taxes were actually assessed and have been paid.

³ This amount has not been assessed but it is proposed to suggest to the taxpayer that he waive his right to file a petition with the Board of Tax Appeals and consent to the assessment and collection of the tax.

The question at issue is whether or not the amounts received by the taxpayer in the years 1918 to 1924, inclusive, and treated by him as a return of capital was the correct treatment of the amounts received. The unit states the reasons for treating the amounts received as income as follows:

"Information obtained from Mr. Bishop discloses that pending final closing of the returns of the Utah Copper Co. for the years 1920 to 1925, inclusive, the bureau holds that the entire distributions made by that corporation in those years are 100 per cent taxable to the stockholders.

"The corporation returns for the years 1920 to 1922, inclusive, are charged to section G of the consolidated audit division. Since action on those returns is deferred pending receipt of information from the field division, no assurance could be obtained from the auditor handling those cases that final closing of the corporation returns would be made within the next one and one-half years. The corporation returns for the years 1923 to 1925, inclusive, are at this time being made the subject of a traveling auditor's investigation.

"Since the statutory period within which allowance of the overassessment of \$106,626.23 on the taxpayer's 1925 return will expire in approximately one and one-half years, you are requested to advise whether an allowance of the overassessment should be made at this time or the attached letter should be mailed the taxpayer.

CHIEF OF SECTION C.

"MISS NEWBOLD: Mr. Linder says to send letter at 3 car., and issue a C. of O., and if any change is made in report of consolidated audit division we might assess the deficiency at a future date. Make sure that the prior years have been assessed.

"(Signed) W. B. S."

The above is quotation from memorandum in the case, addressed to Mr. Parker Linder, head of the field audit review division.

It is obvious, from this memorandum, that the bureau in taking action on the case is attempting to protect the Government from further possible loss of tax in years prior to 1925. It is not clear, however, how the bureau contemplates that it may be able to make an assessment on the taxpayer if the case has been closed for the year 1925.

Considerable effort has been made to have assembled the case of the Utah Copper Co. for the years 1917 to 1925, but the results have not met with success. I have for examination the years 1918 to 1921, inclusive. There is nowhere in the case, for 1918 to 1920, a correct analysis of surplus, and apparently the bureau's determination that the dividends paid for 1918 to 1925 were all paid out of earned surplus seems to be a mere presumption. The following analysis has been made from what information exists in the case, for the years 1918 to 1925, of earned surplus. The analysis is not a correct one, for the reason that it does not give effect to adjustments of taxable net income for the years 1909 to 1916. These adjustments, however, of the returns were not sufficient increase in income to be a material factor of the question at issue. For that reason I have not delayed making a report on this case until further information could be obtained. You will note this analysis indicates that by the year 1921 earned surplus had been exhausted, and dividends must necessarily have been paid from realized appreciation. The action of the bureau, however, in assessing tax upon these dividends in the year in which received apparently is in favor of the Government, for the reason that the tax on these dividends is much higher than the 12½ per cent tax imposed upon capital gain in the year of sale of the stock. For that reason it is not deemed necessary to follow up the years 1922, 1923, and 1924, which are now in the process of audit, in an attempt to make a complete analysis of earned surplus. Obviously, the taxpayer will protect his interest in due course by proper claims, and it seems proper that the burden of proof as to the source of dividends should rest upon him.

Your attention is called to the fact that additional income for the years 1918 to 1922, inclusive, resulting from the taxpayer's failure to include in income dividends received from the Utah Copper Co., have resulted in a loss of tax to the Government in the amount of \$191,713.57. This apparently is due to the fact that the bureau did not discover the error in the taxpayer's manner of reporting income until after the statute of limitation had run. Just why the error of the taxpayer's treatment of income was not discovered when his returns for the years 1918 to 1922 were audited is not explained. In connection with the examination of this case the reviewer points out that another taxpayer and apparently

one of the stockholders in the Utah Copper Co., also had income during the years mentioned above which was barred by statute. It seems probable, therefore, that the Government may have lost considerable tax on the stockholders of the Utah Copper Co. if all took action similar to the one in this case. It might, therefore, be instructive to examine the individual returns of all the large stockholders of the Utah Copper Co., for the purpose of determining to what extent they have gone in failing to report the dividends from this source. This examination would also disclose any apparent discrepancy in treatment of the stockholders owning stock of the same company.

The reviewer in this case also advised me that the question of allocation of income is still open. In this connection, it should be pointed out that it is possible that the taxpayer might permit the statute to run against the year 1925, after which time claims for refund in the amount of tax paid for the years 1920, 1923, and 1924, as shown in this memorandum, could be made the subject of claims for refund, and, if the allocation as now made is incorrect, the taxpayer would be entitled to refunds, yet the bureau would be without authority to impose additional tax for 1925. It has not been disclosed just how the bureau keeps track of cases involving a dividend determination, as is shown in this case. I think it is probable that they are only revived for examination upon request of the taxpayer, with the result, in most instances, of loss in revenue to the Government.

Respectfully,

(Signed)

G. D. CHESTEEN,
Corporation Auditor.

SCHEDULE A

Analysis of surplus, Utah Copper Company

Surplus at date of incorporation, June 3, 1904-----		
Net income June 3, 1905-----		\$142,487.95
Total-----		142,487.95
Add: Net income, June 30, 1906-----		188,143.29
Total-----		330,631.24
Add: Net income, June 30, 1907-----		295,129.41
Total-----		625,760.65
Add: Net income 18 months, Dec. 31, 1908-----		2,361,398.38
Total-----		2,987,159.03
Less: Dividends-----		696,387.50
Surplus, Dec. 31, 1908-----		2,290,771.53
Add: Net profit, Dec. 31, 1909-----		2,154,742.80
Total-----		4,445,514.33
Less: Dividends-----		1,464,387.50
Surplus, Dec. 31, 1909-----		2,981,126.83
Add: Net income, 1910-----		5,401,587.73
Total-----		8,382,714.56
Less:		
Dividends-----	\$4,648,675.50	
Bonus paid on retirement of bonds-----	37,500.00	
		4,686,175.50
Surplus, Dec. 31, 1910-----		3,696,539.06
Add: Net profits for 1911-----		6,237,928.44
Total-----		9,934,467.50
Less:		
Dividends paid during year-----	\$4,703,022.00	
Part of prepaid ore account (stripping expense) written off-----	2,500,000.00	
		7,203,022.00
Balance: Surplus Dec. 31, 1911-----		2,731,445.50

Add: Net profit for the year ended Dec. 31, 1912.....		\$8, 449, 272. 51
Total.....		11, 180, 718. 01
Less: Dividends paid during the year.....		4, 729, 747. 50
Balance: Surplus Dec. 31, 1912.....		6, 450, 970. 51
Add: Net profit for the year 1913.....		8, 005, 392. 96
Total.....		14, 456, 363. 47
Less: Dividends paid during the year.....		4, 747, 710. 00
Balance: Surplus Dec. 31, 1913.....		9, 708, 653. 47
Add: Net profit for the year 1914.....		8, 154, 640. 04
Total.....		17, 863, 293. 51
Less: Dividends paid during the year.....		4, 827, 885. 00
Balance: Surplus Dec. 31, 1914.....		13, 035, 408. 51
Add: Net profit for the year 1915.....		17, 366, 747. 80
Total.....		30, 402, 156. 31
Less: Dividends paid during the year.....		6, 904, 082. 50
Balance: Surplus Dec. 31, 1915.....		23, 498, 073. 81
Add: Net profit for the year 1916.....		39, 148, 943. 62
Total.....		62, 647, 017. 43
Less: Dividends paid during the year.....		19, 493, 880. 00
Balance: Surplus Dec. 31, 1916.....		43, 153, 137. 43
Less:		
Depreciation—		
Total deducted on in-		
come tax returns.....	\$3, 237, 521. 36	
Set up on books.....	2, 168, 028. 38	
Difference.....		\$1, 069, 492. 98
Depletion on costs to Mar. 1, 1913.....		1, 865, 793. 07
Depletion on Mar. 1, 1913 value—		
1913.....		2, 411, 740. 40
1914.....		2, 808, 932. 77
1915.....		3, 463, 069. 21
1916.....		4, 360, 840. 57
		15, 979, 869. 00
Balance.....		27, 174, 268. 43
Add: Stripping expense charged to surplus 1911 restored.....		2, 500, 000. 00
Surplus Dec. 31, 1916, as adjusted.....		29, 674, 268. 43
Net income 1917.....		26, 492, 528. 11
Total.....		56, 166, 796. 54
Deduct:		
Dividends paid.....	\$25, 991, 840. 00	
Federal Income Tax for 1916.....	634, 230. 38	
		26, 626, 070. 38
Surplus Dec. 31, 1917.....		29, 540, 726. 16
Net income 1918.....		13, 187, 095. 74
Total.....		42, 727, 821. 90
Deduct:		
Federal income tax for 1917.....	4, \$443, 887. 58	
Dividends.....	16, 244, 900. 00	
		20, 688, 787. 58
Surplus Dec. 31, 1918.....		22, 039, 034. 32

Net income for 1919.....		\$4, 697, 753. 13
Total.....		26, 736, 787. 45
Deduct:		
Dividends.....	\$9, 746, 940. 00	
Donations.....	500, 000. 00	
Federal income tax for 1918.....	3, 685, 889. 97	
		13, 932, 829. 97
Surplus Dec. 31, 1919.....		12, 803, 957. 48
Net income for 1920.....		2, 116, 556. 12
Total.....		14, 920, 513. 60
Deduct:		
Dividends.....	\$9, 746, 940. 00	
Federal income tax.....	408, 359. 51	
		10, 155, 299. 51
Surplus Dec. 31, 1920.....		4, 765, 214. 09
Deduct:		
Net loss for 1921.....	\$2, 879, 067. 30	
Dividends.....	¹ 4, 061, 225. 00	
		6, 940, 292. 30
Deficit Dec. 31, 1921.....		(2, 175, 078. 21)

SCHEDULE B

Depreciation accrued per Books, Utah Copper Co.

1904 to Dec. 31, 1909.....	None.
1910.....	None.
1911.....	None.
1912.....	None.
1913.....	\$507, 712. 21
1914.....	523, 850. 89
1915.....	546, 733. 54
1916.....	589, 731. 74
	2, 168, 028. 38
Reserve for depreciation Oct. 31, 1913.....	507, 712. 21
Depreciation for 1914.....	523, 850. 89
Reserve for depreciation Dec. 31, 1914.....	1, 031, 563. 10
Depreciation for 1915.....	546, 733. 54
Total.....	1, 578, 296. 64
Depreciation for 1916.....	589, 731. 74
Total.....	2, 168, 028. 38
Less replacement written off against reserve.....	42, 911. 05
Total.....	2, 125, 117. 33
Reserve for Bingham & G. Ry. subsidiary.....	374, 397. 50
Reserve for depreciation per books, Dec. 31, 1916.....	2, 499, 514. 83

SCHEDULE C

Depreciation deducted on income-tax returns, Utah Copper Co.

1909.....	None.	1914.....	\$523, 850. 89
1910.....	\$323, 782. 28	1915.....	546, 733. 54
1911.....	349, 187. 75	1916.....	589, 731. 74
1912.....	396, 522. 95		
1913.....	507, 712. 21		3, 237, 521. 36

¹ Out of realized appreciation.

MARCH 31, 1926.

ENGINEERING DIVISION, MINING SECTION—VALUATION
MEMORANDUM

UTAH COPPER CO., SALT LAKE CITY, UTAH

Reference: IT:CR:G-1:CWZ.

Taxable years: 1919, 1920, 1921.

Operating owner: Bingham, Utah.

Revaluation as of March 1, 1913, for the determination of depletion allowable as deduction from income in 1919 and subsequent years has resulted in the selection of the following factors, as determined in conference agreement March 16 and 17, 1926. To this agreement the taxpayer has reserved objection to the legality of any revaluation and, in case of revaluation, to the respreading of depletable value remaining as of January 1, 1919. These principles, however, are basic, and subject only to the orders of the commissioner.

In the following valuation, the factors and results only are given. The substantiating data in the valuation files cover the points involved in the selection of the factors used.

Ore reserves (tons) ----- 445, 068, 075

From report of R. C. Gemmell, general manager, to D. C. Jackling, vice-president and managing director, dated April 5, 1919. Summary, page 9, of that report. Attached to Form A-MMs, page 17.

Grade per cent copper ----- 1. 3838

From same summary.

Mill recovery:

(a) As of Mar. 1, 1913, and for three years, per cent ----- 65
(b) From Mar. 1, 1916, to end of life, per cent ----- 85

The first period represents current recovery immediately preceding basic date; the second period represents recovery expectable according to letter of Minerals Separated (Ltd.), to Pope Yeatman (consulting engineer for the taxpayer), dated October 5, 1912, guaranteeing 85 per cent recovery.

Smelter recovery, per cent ----- 95

Contract dated October 25, 1905.

Metal prices: Copper at 15 cents; gold and silver contents amounting to approximately 11 cents per ton of ore, are credited in arriving at expected operating cost.

Operating cost, per ton ----- \$1. 23

This is the average of the years, 1913, 1914, 1915, and 1916 (statement received March 16, 1926) including development (stripping) but excluding depreciation. Also, Form A dated June 17, 1919, pages 26 and 27. Taken as expectable for entire life on theory that diminished costs due to improved efficiency would be offset by flotation expenses in second period.

Life (as determined by plant capacity):

(a) Three years at daily capacity of 22,750 tons (or the actual, during three years, excluding the period August to December, 1914), as at basic date, years ----- 3
(b) Remainder of life at 35,000 tons per day (letter from D. C. Jackling to C. M. MacNeill, dated September 8, 1913), this capacity having been reached in 1917, years ----- 33

Risk rate:

(a) Three years, existing recovery and capacity, per cent ----	7 and 4
(b) Thirty-three years, flotation and increased capacity, per cent -----	8 and 4
(c) Deferred 3 years, at 8 per cent.	

Plant and equipment:

As of Mar. 1, 1913 (actual) -----	\$8, 950, 455
To increase capacity and install flotation -----	5, 500, 000
Replacements during life -----	8, 000, 000

Valuation as of March 1, 1913

Period (a):

Tons per day 22,750; 3 years at 360 days, tons -----	24, 570, 000
Contents per ton 1.3838 per cent=27.676 pounds.	
Recovery 65 per cent×95 per cent=6.75 per cent, pounds ----	419, 899, 580
Gross return, at 15 cents per pound -----	\$62, 984, 937
Operating cost, at \$1.23 per ton -----	\$30, 221, 100

Gross operating profit -----	32, 763, 837
Present worth factor, 3 years at 7 per cent and 4 per cent -0.853937.	
Mar. 1, 1913, value of operating profit -----	27, 978, 253
Less: Mar. 1, 1913, plant -----	8, 950, 455

Mar. 1, 1913, value of ores only, period (a) -----	19, 027, 798
--	--------------

Period (b):

Ore reserve remaining (445,068,075-24,570,000)=420,- 498,075 tons.	
Recovery, 85 per cent×95 per cent=80.75 per cent ----- pounds--	9, 397, 446, 564
Gross return, at 15 cents per pound -----	\$1, 409, 616, 984
Operating cost, at \$1.23 per ton -----	517, 212, 632

Gross operating profit -----	892, 404, 352
Less plant replacement -----	8, 000, 000

Net operating profit -----	884, 404, 352
Present worth factor, 33 years at 8 per cent and 4 per cent-0.318631.	

Mar. 1, 1916, value of net profit -----	281, 798, 643
Less additions to Mar. 1, 1913, plant and flotation -----	5, 500, 000

Value of ores only, Mar. 1, 1916 -----	276, 298, 643
Deferment factor, 3 years at 8 per cent-0.793832.	
Present worth Mar. 1, 1913, period (b) -----	219, 334, 704
Plus present worth Mar. 1, 1913, period (a) -----	19, 027, 798

Total value ores only, Mar. 1, 1913 -----	238, 362, 502
---	---------------

Total pounds recoverable copper:

419,899,580+9,397,446,564=9,817,346,144.

Unit of depletion: \$0.02427973.

Depletion sustained

Year	Pounds of copper	Unit ¹	Depletion
1913.	113, 942, 834	\$0. 02427973	\$2, 766, 501. 24
1914.	115, 690, 445	. 02428973	2, 808, 932. 77
1915.	148, 397, 006	. 02427973	3, 603, 039. 24
1916.	187, 531, 824	. 03393	6, 362, 954. 79
1917.	195, 837, 111	. 03393	6, 644, 753. 18
1918.	188, 092, 405	. 03393	6, 381, 975. 30
Mar. 1, 1913.	949, 491, 625	-----	28, 568, 156. 52
	9, 817, 346, 144	-----	238, 362, 502. 00
Jan. 1, 1919.	8, 867, 854, 519	-----	209, 794, 345. 48
1919.	105, 088, 740	. 0236578	2, 486, 168. 39
1920.	101, 897, 758	. 0236578	2, 410, 676. 78
1921.	24, 511, 593	. 0236578	579, 890. 36

¹ Unit of depletion for 1919 and subsequent years, \$0.0236578.

It should be noted that the foregoing figures are based upon pounds of copper produced, and that they must be adjusted for actual sales.

Recommended by.

Approved:

_____,
Valuation Engineer.

_____,
Chief of Mining Section.

UTAH COPPER COMPANY, 23 BROAD STREET, NEW YORK

Depletion sustained on March 1, 1913, value, under G. C. M. No. 354

Period	Pounds of copper sold	Depletion at \$0.02427973
Mar. 1, 1913, to Dec. 31, 1913.....	99,331,434	\$2,411,740.40
1914.....	115,690,445	2,808,932.77
1915.....	142,632,114	3,463,069.21
1916.....	191,176,084	4,641,703.70
1917.....	179,608,281	4,360,840.57
1918.....	153,335,424	3,722,942.69

For 1919 and subsequent years through 1923, see attached copy of Valuation Memorandum IT:En:M:MT-m, March 28, 1927.

The factors by means of which the March 1, 1913, value was computed have been set forth in Valuation Memorandum IT:En:M:SCS-m, March 31, 1926, copy of which has just been given to Mr. Chesteen, February 13, 1928.

ENGINEERING DIVISION, MINING SECTION—VALUATION MEMORANDUM

MARCH 28, 1927.

UTAH COPPER CO., NEW YORK CITY

Operators (copper): Bingham Canyon, Utah.

Previous memoranda: IT:En:M:SCS-m, March 31, 1926. IT:En:M:NT-m, September 17, 1926.

Returns in case: 1920, 1921, 1922, 1923, all open.

Reference: A.CR:G:CWZ.

1. Required, depletion deductions allowable for the years in question based on sales of copper.

2. The previous memorandum covering 1919 to 1922, inclusive, was based upon the pounds of copper sold as submitted in letter of the taxpayer under date of September 17, 1926.

The travel auditor has recommended that the deliveries of copper to the Copper Export Association (Inc.) in 1921, be treated as sales of such copper in that year at 13.5 cents per pound, subsequent adjustments in price to be reflected in profit and loss at the time when such adjustments became necessary. As set forth in the taxpayer's letter dated March 24, 1927, the sales on which depletion in the prior memorandum, IT:En:M:MT-m, of September 17, 1926, were based,

include only that amount of copper for which the Export Association settled in full each year, Consequently to be consistent, since the audit is to hold the delivery of copper to the association as a sale, the depletion schedule has been revised as follows:

Year	Copper sales	Depletion rate	Depletion allowed
	<i>Pounds</i>	<i>Cents</i>	
1919 -----	94, 637, 310	2. 427973	\$2, 297, 768. 33
1920 -----	96, 709, 215	2. 427973	2, 348, 073. 63
1921 -----	81, 151, 131	2. 427973	1, 970, 327. 55
1922 -----	72, 265, 403	2. 427973	1, 754, 584. 47
1923 -----	173, 796, 979	2. 427973	4, 219, 743. 73

VALUATION MEMORANDUM, UTAH COPPER CO.

Balance remaining as of December 31, 1923: 8,417,012,324 pounds copper, \$204,362,774.95.

4. It is recommended that the above computed depletion be substituted for the depletion allowance used by the travel auditor in his computations.

Recommended by:

MARK TAYNTON,
Associate Valuation Engineer.

Approved by:

STANLEY C. SEARS,
Chief of Mining Section.

EXHIBIT 4(A)

IN RE R. A. F. PENROSE, JR.

TREASURY DEPARTMENT,
Washington, June 11, 1929.

Mr. L. H. PARKER,
*Chief Division of Investigation,
Joint Committee on Internal Revenue Taxation,
Washington, D. C.*

DEAR MR. PARKER: Reference is made to the report of Mr. Chesteen dated February 18, 1928, in the above-named case with particular regard to the comment therein contained as to the loss of tax through the inability to audit the case of the taxpayer for prior years before the expiration of the statutory period for assertion of deficiencies.

It is believed that the audit of the Utah Copper case has progressed as expeditiously as is conformable with an effort at the determination of true statutory tax liability. A final determination would have been far longer delayed had any of the points been subjected to litigation. That the statutory period for reflection of corresponding adjustments to Utah Copper shareholders' tax liabilities has expired while the Utah case was being adjusted is an unfortunate result of the provisions of the present revenue act but does not reflect discredit upon the Bureau in that the Utah Copper audit was being conducted with as much speed as was practicable. It is to be noted, as is indicated in the report of the Utah Copper case itself, page 28, that in excess of \$560,000 overassessment to that company was outlawed. The disadvantage of a delayed closing of a case, which delay is unavoidable as in the instant situation reacted as to both parties.

With respect to the taxpayer, it is desired to stress that even under these circumstances a tax liability with respect to the dividends which were erroneously treated on his returns has been collected in the amount of \$130,186.90 (under final closing agreements) while there has been refunded only \$103,863.32.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury.

EXHIBIT 5

IN RE MONTANA POWER CO., BUTTE, MONT.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,
October 26, 1927.

MR. COMMISSIONER: Certificates of overassessment in favor of the above-named corporation have been prepared as follows:

1920-----	\$35, 660. 71
1921-----	39, 325. 29
1922-----	62, 441. 94

The overassessments are due to allowing additional depreciation on depreciable assets, owing to the fact that depreciation taken on the return was computed on the basis of an arbitrary charge instead of on the basis of 2 per cent on depreciable assets as allowed by the bureau in determining the tax-liability for the years 1917, 1918, and 1919.

There are nine subsidiary companies in this consolidation, four of which are inactive, and the income of all of the rest of the companies was included in the return filed. The outstanding capital stock of all of these subsidiary corporations is 100 per cent owned by the taxpayer, or principal company, and the companies are, therefore, properly affiliated within the purview of section 240 of the revenue act of 1918.

For the year 1920 the taxpayer filed a consolidated return, Form 1120, reflecting a net income of \$3,284,779.33 and an invested capital of \$62,017,899.98, upon which a tax of \$328,267.48 was assessed. In the present audit the consolidated net income used is \$2,928,172.17, a difference of \$356,607.16 from the return, attributable to allowing additional depreciation of \$408,998.12 and to disallowing as deductions increases in reserve for injuries and damages \$17,892.49 and flood damage adjustment, \$34,360.07. The excess profits credit under section 312 of the revenue act of 1918 exceeds the taxable net income, and, therefore, the invested capital has not been computed. Upon this basis the correct tax liability is \$292,606.77, and as taxes in the amount of \$328,267.48 have previously been assessed, there is, therefore, an overassessment of \$35,660.71, which is allowable under section 284(g) of the revenue act of 1926, the taxpayer having filed a waiver before June 15, 1926 and claim was filed before April 1, 1927.

For the year 1921 the taxpayer filed a consolidated return, Form 1120, reporting a net income of \$1,724,648.52 and an invested capital of \$62,584,372.67. Upon the basis of this return a tax of \$172,264.85 was assessed. In the present audit the consolidated net income used is \$1,329,395.57, a decrease of \$395,252.95 from that reported in the return, attributable to allowing depreciation in the amount of \$413,688.44 which is offset, in part, by disallowing as deductions increases in reserve for damages and injuries, \$16,496.05 and other sundry items. The invested capital has not been computed for the same reason as stated for the year 1920. Upon this basis, the correct tax liability is found to be \$132,939.56 and as taxes in the amount of \$172,264.85 have previously been assessed there is an overassessment of \$39,325.29, which is allowable under the provisions of section 284(g) of the revenue act of 1926, the taxpayer having filed waiver before June 15, 1926, and claim was filed before April 1, 1927.

For the year 1922 the taxpayer filed a consolidated return, Form 1120, reporting a consolidated net income of \$2,774,924.18 and upon this return a tax of \$346,615.52 was assessed. In the present audit the consolidated net income is found to be \$2,273,388.65, a decrease of \$501,535.53 from the return, consisting of allowing additional depreciation \$516,403.08 which is offset, in part, by disallowing as deductions the increase in reserve for injuries and damages \$14,774.14 and other sundry items. The correct tax liability is found to be \$284,173.58. There is, therefore, an overassessment of \$62,441.94 for this year, which is allowable under section 284 (b) of the revenue act of 1926, the taxpayer having filed claim within four years from the time the tax was paid.

At the time of filing the returns for each of the three years under consideration the taxpayer took depreciation at the flat rate of 1 per cent, based upon \$30,000,000 of depreciable property. Subsequently the bureau engineers made an investigation of the books and records of the taxpayer corporation in order to determine the tax liability for the years 1917, 1918, and 1919, and determined the value of depreciable assets as of December 31 of each year. Depreciation at the rate of 2 per cent has been allowed on depreciable assets for the years

1917, 1918, and 1919. On October 15, 1925, the taxpayer filed claims for refund for the years 1920, 1921, and 1922, claiming the additional depreciation allowance. The value of depreciable assets at December 31, 1919, has been determined to be \$35,242,499.83, and since the taxpayer was allowed a rate of 2 per cent during the earlier years, said rate is considered to be fair both to the Government and the taxpayer for the years under consideration.

The increases in reserves for injuries and damages and miscellaneous items are disallowed for the reason that these deductions are not evidenced by closed and completed transactions as required by article 141 of Regulations 45. On the return the taxpayer deducted \$76,489.21 from gross income on account of flood damages. This item included \$34,360.07 expended for the purpose of constructing a dike to prevent a recurrence of the flood, which amount is now added to the 1920 taxable income. All of the adjustments made to the taxable income for the years under review are questions of fact which have been verified and accepted by the bureau and are found to be properly established.

It is, accordingly, recommended that the overassessments be allowed.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved: October 27, 1927.

D. H. BLAIR,

Commissioner of Internal Revenue.

EXHIBIT 6

IN RE MONTANA POWER CO., BUTTE, MONT.

MARCH 26, 1928.

Mr. L. H. PARKER,
*Chief Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above-named taxpayer in the amounts, and for the years, as set forth below:

1920-----	\$35, 660. 71
1921-----	39, 325. 29
1922-----	62, 441. 94

The proposed refund for the year 1920 appears to be in error. The basis for this conclusion is set forth below:

FINDING OF FACTS

The commissioner has determined a net income for the year 1920 in the amount of \$2,928,172.17. The excess profits tax is not computed in the final A-2 letter. A previous A-2 letter, however, dated January 18, 1927, disclosed an invested capital of \$40,927,903.94, and, upon the basis of this computation, the commissioner, in the final A-2 letter to the taxpayer, stated that the credit under the provisions of section 312 was in excess of the net income, and for that reason, no excess profits tax was due for the calendar year 1920. The computation of invested capital, as thus disclosed, appears to be in error. The facts and reasons for this position are as follows:

OPINION

The Montana Power Co. was organized in December, 1912, with an authorized capital stock of \$25,000,000 preferred and \$75,000,000 common. The company was organized for the purpose of effecting a merger of a number of small public utilities operating in Montana and adjoining States. At the time of incorporation capital stock was issued for the following companies and their subsidiaries: Butte Electric & Power Co., Madison River Power Co., Missouri River Electric & Power Co., and Billings & Eastern Montana Power Co. These companies, with their subsidiaries, were merged with the Montana Power Co. as a result of their acquisition. The record does not show whether the stock of the Montana Power Co. was issued to the companies direct, or whether it was issued to the stockholders of these companies, after which the companies were liquidated. In either case, the treatment for income tax purposes is the same, and the manner in which the merger was effected is not material.

Among the assets of the Butte Electric & Power Co. was one-half the capital stock outstanding of the Great Falls Water Power & Townsite Co. The taxpayer, in the instant case, desiring to own the entire capital stock of this company, in the following year—that is, the calendar year 1913—issued \$17,500,000 common and \$5,000,000 preferred stock to John D. Ryan, the then owner of the remaining one-half capital stock of the foregoing company. An additional \$5,000,000 capital stock was then issued for the entire capital stock of the Thompson Falls Power Co., the capital stock of the latter company being \$5,000,000.

Subsequent to the acquisition of the Great Falls Water Power & Townsite Co., which was a holding company, the capital stock of the latter was reduced by partial liquidation, in which the stock of its subsidiaries, the Great Falls Power Co. and the Great Falls Townsite Co., were distributed to the parent company. The organization thus effected continued through the taxable years 1917 to 1923. It is apparent, therefore, that the Montana Power Co. issued its stock partly as a result of the merger of certain companies and partly for the acquisition of certain subsidiary companies. For the purpose of invested capital for the years 1917 to 1921 the bureau has consistently held that where stock of a subsidiary is acquired by stock of the parent company, the amount to be included in consolidated invested capital, with respect to the company acquired, is computed in the same manner as if the assets had been acquired instead of the stock. This position has been upheld by the Board of Tax Appeals. (See Hollingsworth, Turner & Co., Vol. I, U. S. Board of Tax Appeals Reports, p. 958.)

The bureau apparently attempted to apply the principle set forth above in the computation of invested capital in this case, but, due to an error in excluding the excess value reported on the return, appears to have allowed an excess amount in invested capital for the year 1920 to the extent of approximately \$16,401,077.74. It is obvious, from the statements set forth above as to the manner of issue of capital stock for assets, that liabilities of all properties merged, as well as affiliated, at the time of issue of capital stock, must be taken into consideration in determining the net amount of capital stock issued for properties. The taxpayer appears to have set up on its books at the time of incorporation, the entire par value of capital stock issued therefor. An appraisal was made of all physical properties, and a write-up in excess of these properties as carried on the predecessor company's books was made to the extent of the amount necessary in order to make a total of assets equal to the total capital stock and liabilities of the companies merged.

Computation of invested capital for 1920 as shown by the bureau in A-2 letter, dated January 18, 1927

Invested capital as shown by return.....	\$63, 231, 451. 38
As corrected.....	40, 927, 903. 94
Net reductions as explained below.....	<u>22, 303, 547. 44</u>

Additions:

(a) Organization expense.....	\$397, 000. 10
(b) Minority interest.....	530. 00
(c) Reserves.....	73, 323. 03
(d) Refund of 1917 Federal income tax....	27, 590. 06
(e) Bond discount amortization.....	10, 576. 20
(f) Overassessment, 1918.....	<u>42, 827. 31</u>

Total additions..... 551, 846. 70

Reductions:

(g) Interest during construction.....	\$885, 581. 01
(h) Appreciation.....	20, 264, 102. 77
(i) Additional depreciation.....	368, 402. 27
(j) Federal income tax for 1919.....	80, 726. 03
(k) Unsubscribed stock.....	13, 183. 61
(l) Employees' stock subscription.....	210, 069. 60
(m) Dividends paid Jan. 1, 1920.....	494, 812. 75
(n) Inadmissibles.....	<u>538, 516. 10</u>

Total reductions..... 22, 855, 394. 14

Net reductions as above..... 22, 303, 547. 44

The corrected invested capital is approximately as follows:

Invested capital as shown above in A-2 letter, dated Jan. 18, 1927.....	\$40, 927, 903. 94
Deduct:	
(a) Appreciation at date of acquisition not eliminated.....	\$16, 401, 077. 74
(b) Additional depreciation for 1918 and 1919 allowed.....	628, 142. 89
(c) Amortization allowed for 1918.....	238, 970. 20
	<u>17, 268, 190. 83</u>
Corrected invested capital.....	23, 659, 713. 11

Explanation of items changed:

(a) Adjustment for appreciation of assets at date of incorporation:	
Value of plant, equipment, water rights, etc., at date of acquisition.....	\$35, 965, 274. 01
Excess of other assets over all liabilities other than bonds of companies outstanding at date of acquisition.....	2, 577, 878. 81
Total.....	<u>38, 543, 152. 82</u>
Less: Par value of bonds outstanding at date of acquisition...	<u>19, 775, 000. 00</u>
Actual cash value for which stock of \$55,433,333.33 was issued.....	18, 768, 152. 82
Par value of stock issued.....	<u>55, 433, 333. 33</u>
Net reductions.....	<u>36, 665, 180. 51</u>
Reduction made by bureau letter, dated Jan. 18, 1927.....	<u>20, 264, 102. 77</u>
Excess invested capital allowed.....	16, 401, 077. 74
(b) Additional depreciation for 1918 and 1919:	

Name of company	Year	Additional depreciation and replacements
Montana Power Co.....	1918	\$145, 537. 57
Montana Reservoir Co.....	1918	11, 923. 35
Idaho Transmission Co.....	1918	2, 535. 63
Thompson Falls Power Co.....	1918	15, 461. 03
Montana Power Co.....	1919	272, 646. 54
Great Falls Power Co.....	1919	147, 531. 81
Thompson Falls Power Co.....	1919	15, 908. 90
Montana Reservoir & Irrigation Co.....	1919	11, 926. 81
Idaho Transmission Co.....	1919	4, 671. 25
Total.....		<u>628, 142. 89</u>

The above additional depreciation has been allowed in the closing of the years 1918 and 1919 in excess of the amount allowed in A-2 letters for those years prior to the date of the issue of the A-2 letter for 1920, as shown above.

(c) Amortization allowed for 1918:

Name of company: Montana Power Co.

Year: 1918.

Amortization allowed: \$238,970.20.

The above represents the amount recommended in an engineer's report, dated January 9, 1928, which appears not to have been given effect to at the time of the preparation of this memorandum.

On the basis of the invested capital set forth above, the approximate additional tax due for the year 1920 is \$259,380.42, as shown by the following computation:

Excess-profits credit:	
8 per cent of invested capital.....	\$1, 840, 777. 05
Special exemption.....	<u>3, 000. 00</u>
Excess-profits credit.....	1, 843, 777. 05

Computation of excess-profits tax: Per cent of invested capital, 20; income, \$3,284,779.33; credit, \$1,843,777.05; balance, \$1,441,002.28; rate, 20 per cent; tax, \$288,200.46.

Brought forward..... \$288, 200. 46
Income tax:

Net income..... \$3, 284, 779. 33

Less: Interest on obligations of

United States not exempt..... \$104. 51

Excess profits tax..... 288, 200. 46

Exemption..... 2, 000. 00

290, 304. 97

Balance taxable at 10 per cent..... 2, 994, 474. 36 299, 447. 44

Total income and excess profits tax..... 587, 647. 90

Tax previously assessed..... 328, 267. 48

Additional tax due for 1920..... 259, 380. 42

Inasmuch as the commissioner has proposed a refund of \$35,660.71, whereas there appears to be an additional tax due of approximately \$260,000, it would appear that the apparent error should be called to the attention of the bureau in order that the determination might be made of whether or not a refund should be proposed in this case.

VALUATION OF PROPERTIES

The result of book entries at the date of incorporation and acquisition of the properties was to record in the account of properties, an excess value sufficient to set up the par value of the capital stock of the companies. The taxpayer, in the year 1913, appears to have made an appraisal of the properties for the purpose of rates, and, in accordance with this determination, made claim to its original book entries for valuation of properties. An engineer of the amortization section of the Internal Revenue Bureau, J. W. Swaren, was assigned to this case, and, after an exhaustive examination, set up a valuation of physical properties at the date of acquisition of the companies, in the following amounts:

Subsidiary	Value of—			Total
	Physical assets	Water rights	Intangibles	
Butte Electric & Power Co.....	\$3, 000, 348. 57	-----	\$379, 029. 40	\$3, 379, 377. 97
Madison River Power Co.....	4, 508, 209. 76	-----	-----	4, 508, 209. 76
Billings & Eastern Montana Power Co.....	1, 549, 008. 08	\$9, 760. 40	987, 917. 90	2, 546, 686. 38
Missouri River Electric & Power Co.....	7, 699, 029. 02	-----	-----	7, 699, 029. 02
Thompson Falls Power Co.....	145, 833. 43	2, 234, 188. 28	-----	2, 380, 021. 71
Great Falls Power Co.....	8, 016, 407. 29	7, 150, 042. 00	-----	15, 166, 449. 29
Rainbow Hotel (two-thirds interest).....	185, 925. 33	-----	-----	185, 925. 33
National Realty Co. (one-half interest).....	22, 593. 75	-----	-----	22, 593. 75
Total.....	25, 127, 355. 23	9, 393, 990. 68	1, 366, 947. 30	35, 888, 293. 21

It is therefore recommended that for the purpose of computing the invested capital of the taxpayer the sum of \$35,888,293.21 be established as the values of properties acquired by stock issue at the time of merger.

In addition to the above properties the taxpayer made claim for other properties acquired by stock issue, as follows:

Value of assets acquired

Subsidiary	Date of acquisition	Physical assets
Conrad Electric & Power Co.....	Oct. 1, 1913	\$21, 757. 87
Mesa Power Co.....	Aug. 5, 1914	55, 222. 93

All costs and audit features of this appraisal are subject to check by the auditor or revenue agent assigned to the field investigation of this case.

Protest to this valuation appears not to have been made. The record indicates that the taxpayer accepted immediately the valuation proposed by the bureau. This valuation, it will be noted, has been used in the computation of the corrected invested capital. The engineer, in making the computation of the value of water rights, utilized the records and results of the taxpayer for the period 1913 to the date of the examination, 1923. He also made approximations and speculations as to what the possibilities as to earning power and increase in the plant and development of water rights would be up to 1942. The utilization of subsequent results of a taxpayer and the approximation of a long period of future years as to growth of population, increase in industrial plants, and amount of electricity to be used to establish the value of water rights at a given date, in order to prove the actual cash value of stock issued therefor for invested capital, appears open to question in the light of the provisions of section 326 of the revenue act of 1918. It is not believed, however, in view of the amount established for water rights, that even though the principles adopted may be open to question the results should be criticized. Comparison of the market value of the capital stock of the company immediately after incorporation while probably influenced by future possibilities, yet is some indication of the value of properties acquired. According to stock quotations, the stock of the company on March 1, 1913, had a value of approximately \$45 per share. Careful study of the whole file in the case with respect to the valuation of the property convinces the reviewer that the value recommended by the engineer is reasonable and is not open to question.

COMMENTS AS TO PRIOR YEARS

The apparent overstatement of invested capital as shown for the year 1920 was also made in the years 1918 and 1919. In those years, the taxpayer was determined not to be subject to excess profits tax, and a refund was granted in each year, the amount being approximately \$80,000 for both years. A tentative approximation of the apparent error for the year 1918 would indicate an additional tax was due of approximately \$750,000. The taxpayer, in the year 1918, reported an income of approximately \$3,200,000. This gives an approximate tax of 25 per cent. The question of whether or not the taxpayer might be entitled, under those circumstances, to special assessment, of course, can not be approximated. It is possible that if a tax of this amount had been proposed, the taxpayer would have been entitled to some reduction of the \$750,000, on the basis that the tax should have been determined in comparison with representative corporations doing similar business, as provided in sections 327 and 328 of the revenue act of 1918. The years 1918 and 1919 appear to have been outlawed so far as the right of the Government to impose an additional tax is concerned. There is, however, apparently a claim pending for further refund for the year 1918, based upon the fact that the bureau has proposed to allow amortization in the amount of approximately \$238,000. It is obvious that the taxpayer would be entitled to at least \$25,000 further refund for the year 1918, unless the correction for invested capital, mentioned, is made.

For the year 1919, it has not been deemed necessary to set up a computation for invested capital. An approximation of the invested capital would indicate that a small amount of excess profits tax would have been due for that year, but inasmuch as the statute has run as to additional assessment, and no claims for further refund are pending, it has not been necessary to make the computation.

For the year 1921, the reviewer has not made a computation of invested capital. It is assumed that the bureau in reviewing the question raised as to 1920, will make proper correction of any adjustment found necessary with respect to 1921, if it is found that an excess profits tax is due for that year.

Respectfully,

G. D. CHESTEEN, *Corporation Auditor.*

EXHIBIT 6

IN RE MONTANA POWER CO., BUTTE, MONT.

MAY 11, 1928.

Mr. L. H. PARKER, *Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

MY DEAR Mr. PARKER: Reference is made to memorandum of March 26, 1928, dealing with the review of the case of the Montana Power Co., for the years 1919 and 1920.

Mr. Sherwood, Assistant Deputy Commissioner, called me this morning to know how the joint committee stood with respect to this case. I advised him that a memorandum had been transmitted to you at the time of the examination and that the case had been discussed with you in a general way, especially with respect to the valuation of water-power rights. Full discussion has been had with the bureau employees with respect to this valuation, and it is claimed that the valuation of approximately \$9,000,000 for water rights, shown in the valuation report of J. W. Swaren, represents the net value of water rights after deducting approximately \$17,000,000 of outstanding bonds at the date of incorporation. You were advised, in the memorandum referred to above, of the general principles employed in making the valuation for invested capital of water rights at the date of incorporation. These, in substance, were based upon results up to the date of the examination in 1923, together with an estimate of all possible results to the year 1943. The engineer employed these results as if they were definitely known in December, 1912, for the purpose of making a correct valuation of water rights. The whole valuation of water rights indicates that the engineer gave entirely too much weight to future possibilities and let his imagination run wild.

Mr. Sherwood was advised that the principles employed in the valuation of water rights had been communicated to you in a general way. Furthermore, he was given a history of the case in so far as it was possible for me to advise him. He was further advised that the case appeared to be a typical special assessment case, and the value of water rights at the time of incorporation had not appeared to be susceptible of a definite determination sufficient to meet the requirements of section 326 of the revenue act of 1918 for invested capital purposes.

There is the further consideration too, that approximately \$55,000,000 of stock was issued for the properties and other stocks acquired at date of incorporation. All these stocks ultimately will be sold and, if the present valuation is permitted, it would seem all stockholders would have good grounds for claiming this valuation as a basis for gain or loss on ultimate disposition of their stock. If this valuation is erroneous, apparently there would be a substantial amount of tax ultimately lost to the Government.

There are two other factors that do not seem to have gained much consideration in the action of the bureau: First, the stock, according to the manual prepared by Prentice-Hall for the year 1928, was offered on March 1, 1913, approximately 90 days after incorporation, at \$44 and the asked price was \$46 per share. This price, as I recall, would only give about \$9,000,000 for water rights rather than \$26,000,000 which it is now proposed to give. My examination did not disclose that the predecessor companies had operated at a profit, or what the profits were. Apparently these properties were brought together under one management for the purpose of effecting a more economical administration of the properties, and, for that reason, the earnings of the predecessor companies, of course, are not conclusive, but should be given some consideration.

All statements given in this memorandum were discussed in a general way with Mr. Sherwood on this date by telephone, and he was advised to communicate with you with reference to the attitude which the committee will finally take toward the proposed refund in this case.

Respectfully,

G. D. CHESTEEN, *Corporation Auditor.*

EXHIBIT 6(A)

IN RE MONTANA POWER CO., BUTTE, MONT.

TREASURY DEPARTMENT,
Washington, June 11, 1929.

MR. L. H. PARKER,
*Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.*

DEAR MR. PARKER: There is transmitted herewith a copy of a memorandum prepared by the bureau valuation engineers in connection with the determination of the value of assets paid in for the capital stock of the above-named company.

This information has been compiled in answer to the questions raised in the report of Mr. Chesteen in this case addressed to you under date of March 26, 1928.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of Treasury.

MEMORANDUM IN RE MONTANA POWER CO., BUTTE, MONT.; YEARS 1918 TO 1921,
INCLUSIVE

APRIL 25, 1928.

Reference is made to the memorandum dated March 30, 1928, from E. C. Alvord, special assistant to the Secretary of the Treasury, inclosing a communication from L. H. Parker, Chief of the Division of Investigation of the Joint Committee on Internal Revenue Taxation, directing attention to an alleged discrepancy in the determination of invested capital for the taxable years 1918 to 1921, inclusive, for the above-named company.

The above-mentioned discrepancy involves the value of properties acquired for stock at the date of organization in 1912. The auditor for the joint committee contends that the proved value of assets as fixed by the examining engineer should be reduced by the amount of the bonds assumed at the date of the merger. The facts relative to the organization of the taxpayer are as follows:

The Montana Power Co. was organized for the purpose of effecting a merger of various public utilities operating in Montana and adjoining States. In effecting this merger, capital stock, common and preferred, was issued amounting in the aggregate to \$55,433,333.13. The taxpayer also assumed the outstanding bonds of the companies taken over, aggregating \$19,775,000. The taxpayer in an attempt to establish the value of its properties *acquired for stock* at date of organization, in its brief presented three methods of valuing such properties, namely:

1. Appraisals, contemporary and retrospective.
2. Stock sales prices.
3. Capitalization of earnings.

The appraisal submitted, which included all physical properties (exclusive of water rights) was undertaken December 31, 1913 (approximately one year after organization by William J. Hagensch, public utility statistician, to determine the fair valuation of such properties in order to establish the rates for sale of electric current. The valuation placed upon the physical properties by this appraisal amounted to \$30,182,062. In February, 1923, A. C. Pratt, an electrical engineer, an employee of the taxpayer, made a valuation as of December, 1912, of the water power rights taken over at date of organization. The appraisal indicated a value with respect to this class of tangible assets aggregating \$43,174,400. Based on these two appraisals the taxpayer claims a value attributable to the *stock* issued therefor amounting to \$53,561,462, as follows:

Value of physical properties shown by Hagensch's report.....	\$30, 182, 062. 00
Value of water powers shown by Pratt's report.....	43, 174, 400. 00
Gross value of properties.....	73, 356, 462. 00
Less bonds.....	19, 775, 000. 00
Available for <i>stock</i>	53, 581, 462. 00

The bureau did not accept the values shown by the taxpayer, but in May, 1923, sent an engineer from the amortization section to Montana for the purpose of determining the value of the properties acquired by the issuance of capital stock. The bureau engineer, in report dated August 31, 1923, determined a value of \$35,888,293.21, detailed as follows:

Physical assets.....	\$25, 127, 355. 23
Water rights.....	9, 393, 990. 68
Intangible.....	1, 366, 947. 30
Total.....	35, 888, 293. 21

In concluding his report the bureau engineer makes the following statement:

"It is therefore recommended that *for the purposes of invested capital* of the taxpayer that the sum of \$35,888,293.21 *be established* as the value of properties *acquired by stock* at the time of merger."

It is quite evident that the taxpayer has claimed the amount of \$53,581,462 as the value for which capital stock was issued, exclusive of outstanding bonds and other liabilities assumed for the taxpayer, and in arriving at this figure reduced the gross valuation by the amount of such liabilities. Therefore, this was the figure upon which the engineer was requested to pass, and his language indicates that the value fixed by him, \$35,888,293.21, was the correct net value for which capital stock was issued. The field examining officer in compiling his report, interpreted the engineer's valuation to represent only the value of property for which *stock was issued* and computed the invested capital accordingly.

A careful analysis of the engineer's report and schedules attached thereto discloses that in the computation of values of water-power rights and intangibles full effect has been given to the bond issue by providing for full retirement and interest charges before computing any values attributable to earnings, and that without question the value of \$35,888,293.21 computed by the engineer is the net value attributable to the stock issued for the properties.

By using the above method the engineer has arrived at a net value which is apparently more favorable to the Government than if he had first computed the gross value and then deducted the bond issue of \$19,775,000. Had he followed the latter method earnings would not have been reduced by bond interest, and sinking-fund payments before computing water power and intangible values and the resulting net value of properties attributable to the stock issued would have been greater than the figure allowed.

In the memorandum from Mr. Parker it is mentioned that it is possible that if the case were adjusted under the special assessment provisions the profits tax on the basis of the suggested revised statutory capital might be substantially reduced. A check of the data cards in the special assessment section of the bureau indicates that comparative companies either paid no profits tax or that their percentage of profits tax to net income was very low. This check indicates that the taxpayer's profits tax would either be wiped out or nearly so if the special assessment provisions were applied.

E. T. LEWIS,
Reviewer, Consolidated Returns Audit Division.
J. M. CLACK,
Chief, Appraisal Subsection.

Approved.

H. B. ROBINSON,
Head, Consolidated Returns Audit Division.

EXHIBIT 7

IN RE DIAMOND COAL & COKE CO., PITTSBURGH, PA.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,
December 13, 1927.

Mr. COMMISSIONER: The audit of the above-entitled case results in an over-assessment of \$79,890.72 for the calendar year 1918. On the tax return filed by the corporation, the taxable net income reported was \$588,408.49 and upon this amount was assessed a tax of \$258,656.58. An additional tax of \$7,054.66 was assessed on January, 1924, list as the result of adjusting the statutory invested capital on account of inadmissible assets and depreciation and depletion for prior years. The present audit reduces the net income by \$43,739.68 on account of the allowance of amortization of war facilities, and increases the invested capital by \$64,145.91 representing paid-in surplus.

The audit for the year under consideration is upon the consolidated basis, the parent company owning all of the outstanding capital stock of the subsidiary company, and, therefore, the two corporations are properly affiliated for tax purposes under the provisions of section 240 (b) of the revenue act of 1918. It appears that on May 1, 1915, the Diamond Coal & Coke Co. purchased the entire outstanding capital stock of the Blaine Coal Co. of a par value of \$100,000 for \$300,000 in cash. The Blaine Coal Co. continued to operate as a separate company until May 1, 1917, when all the physical properties were turned over to the Diamond Coal & Coke Co., and on its books of account the capital stock was reduced from \$100,000 to \$1,000, which latter amount represented the value of the charter. The charter of the company has not been surrendered or canceled, and the balance sheets of the company for the year 1918 show the capital stock outstanding to be \$1,000. Although this company has no income during the taxable year, it has been held to be properly affiliated because of the ownership of its entire outstanding capital stock by the Diamond Coal & Coke Co., and being consolidated for the taxable year, the pre-war income, and pre-war capital used in determining the war profits credit under section 311 of the act have likewise been computed upon the same basis. (Arts. 802 and 869, Regulations 45.)

The tax return filed by the taxpayer corporation showed war profits tax of \$55,454.47. It was discovered, however, that the income for the pre-war period had been understated by reason of the fact that depletion had been taken as a deduction. Section 320 (a) (1) of the act provides that for this purpose, the income for the years 1911 and 1912 should be computed upon the same basis and in the same manner as provided in section 38 of the act approved August 5, 1909, and in the case of Von Baumbach, Collector, v. Sargent Land Company (242 U. S. 503), published as T. D. 2436, no deduction is allowable for depletion under such act. The 1913 act provides for a reasonable allowance for depletion of natural deposits. Accordingly, the depletion taken by the taxpayer prior to the passage of the 1913 act has been restored to income for the pre-war period with the result that the war profits credit computed upon the basis of corrected income for the pre-war period, reflects a war profits tax less than the excess profits tax and under the limitation of section 301 (a) of the act, there is no war profits tax due for the taxable year. This is true whether the war profits credit is computed on a consolidated basis or on the basis of the Diamond Coal and Coke Co. standing alone.

The taxpayer made no claim for amortization on its tax return but on March 12, 1924, a claim for refund was filed claiming amortization of war facilities in the amount of \$402,659.57. This corporation was organized in the year 1903 under the laws of the State of Pennsylvania, and is engaged in operating coal mines. During the war, the company increased its facilities to meet the increased demands, and it is upon such additions that amortization is claimed. No contractual amortization has been received by the taxpayer, and the date of cessation of operation as a war facility is December 31, 1918. The facilities in question are railroad sidings, tipples, and other like equipment. An investigation by the engineers of the Income Tax Unit discloses that the depreciated cost allowable for computing amortization is \$183,897.54, and the residual value has been determined to be \$140,157.86, or an indicated deduction for amortization of \$43,739.68.

With regard to the increase in invested capital of \$64,145.91, it appears that the taxpayer corporation on May 1, 1915, acquired the outstanding capital stock of the Blaine Coal Co. for \$300,000 in cash, but the company set up on its books \$235,854.09 representing the book value of such stock. The difference between the book value of the stock and the cash consideration paid, or \$64,145.91, was not credited to the surplus account until sometime during the year 1918. Inasmuch as the taxpayer is entitled to include in its invested capital the cash consideration paid for the stock of the Blaine Coal Co., and as the amount in question is not included in the surplus as at the beginning of the year, the same has been restored to the surplus account for invested capital purposes. The above adjustments are based upon specific contentions, set forth in claims filed within the statutory period for filing claims. As the adjustments made in this audit appear to be correct, it is recommended that the overassessment be allowed.

C. M. CHAREST,

General Counsel, Bureau of Internal Revenue.

Approved: December 14, 1927.

D. H. BLAIR,

Commissioner of Internal Revenue.

EXHIBIT 8

FEBRUARY 9, 1928.

Mr. E. C. ALVORD,

*Special Assistant to the Secretary of the Treasury,
Washington, D. C.*

My DEAR Mr. ALVORD: In regard to the proposed refund in the case of the Diamond Coal and Coke Co., Pittsburgh, Pa., it appears that there may be an error in the computation of this refund, due to the allowance of both amortization, and depreciation on the same property in the same year. I inclose herewith a copy of a report addressed to me from Mr. Chesteen, corporation auditor of this committee, which outlines his opinion in regard to the apparent error, above noted.

This refund is contained on Schedule No. 28092, the date of payment being March 19, 1928.

Please advise me as to the opinion of the General Counsel on the question raised.

Very truly yours,

L. H. PARKER.

EXHIBIT 9

IN RE DIAMOND COAL & COKE CO., PITTSBURGH, PA.

FEBRUARY 7, 1928.

Mr. L. H. PARKER,
*Chief Division of Investigation,
 Joint Committee on Internal Revenue Taxation,
 House Office Building, Washington, D. C.*

My DEAR MR. PARKER: An examination of the proposed refund in the above named case for the taxable year 1918, in the amount of \$79,890.72, results in the following report:

FINDING OF FACTS

The taxpayer is engaged in the mining of coal, operating four mines in the vicinity of Pittsburgh. During the year 1917 and 1918, certain equipment was acquired for these mines on which amortization has now been allowed. The cost of the facilities and the amortization allowed are as follows:

Kind of equipment	Cost	Name of mine	Amortization allowed
Railroad siding.....	\$78,869.38	Oakmont.....	\$15,773.88
Tipple construction and improvements.....	87,593.25	do.....	17,518.65
Equipment.....	4,337.57	Diamond.....	2,164.31
Improvements.....	553.60	do.....	279.99
Equipment.....	10,264.13	Blaine.....	6,230.97
Improvements.....	2,965.99	do.....	1,771.88
Total.....	184,583.92		43,739.68

Letters were mailed under dates of December 16, 1921, October 9, 1922, December 4, 1923, and August 15, 1925, in which no amortization was allowed, but depreciation was computed upon all facilities acquired to the end of the taxable year. Under date of November 6, 1926, a letter was mailed which gave effect to the proposed amortization allowance in the amount of \$43,739.68. This letter, however, made no adjustment for depreciation on amortized facilities which had been allowed in all previous letters.

OPINION

Article 182, Regulations 45, reads in part as follows:

The allowance for amortization shall be inclusive of all depreciation during the amortization period on property subject to amortization. (See article 186.) * * *

Inasmuch as amortization and depreciation both have been allowed on the cost of property, as mentioned above, the proposed refund is in error to the extent of the tax based upon the double deduction proposed. Inasmuch as the correction appears to be approximately \$10,000, it would appear advisable to advise the bureau of the error made in the audit of the case.

Respectfully,

G. D. CHESTEEN,
Corporation Auditor.

P. S. Since the 60-day period does not expire until March 19, sufficient time remains to enable the bureau to make correction prior to that date.

EXHIBIT 10

IN RE DIAMOND COAL & COKE CO., PITTSBURGH, PA.

AUGUST 11, 1928.

Mr. E. C. ALVORD,
Special Assistant to the Secretary of the Treasury:

Reference is made to your letter of February 9, 1928, inclosing a report made by Mr. G. D. Chesteen, corporation auditor for the committee, on the proposed

refund of \$79,890.72 (Schedule No. 28092), covering the tax liability of the Diamond Coal & Coke Co., Pittsburgh, Pa., for the year 1918, and asking for an expression of opinion by this office as to a possible error in the computation of this refund due to the allowance of both amortization and depreciation on the same property.

An examination of the record disclosed that amortization in the amount of \$43,739.68 has been allowed on costs aggregating \$184,583.92. No deduction was taken for amortization on the tax return filed by the taxpayer corporation, and the depreciation schedules attached thereto do not contain sufficient detail to enable a definite identification of the respective assets upon which depreciation was allowed. From the circumstances, however, it seems reasonable to assume that the taxpayer did not fail to take depreciation on all the physical assets in its possession during 1918, and inasmuch as no elimination was made in the computation for amortizable assets, a duplication in deductions would be indicated. Because of the inability to determine the facts in the case and being essentially a matter of accounting detail, it was deemed advisable to return the record to the Income Tax Unit for further consideration. The unit now reports the following:

DIAMOND MINE

The report of the coal valuation section dated May 13, 1924, determined the total depletion and depreciation on a unit basis and fixed the rate at 0.25061, the unit rate being determined upon the tonnage recoverable and the value of the assets employed as at March 1, 1913. The amortization allowance in the case of this mine is upon additional motors, machinery, railroad sidings, and auto trucks acquired or installed during the war period and it is, therefore, the opinion of this office that no duplication of deductions resulted.

BLAINE MINE

The coal valuation section report dated February 12, 1924, determined a total unit rate for depletion and depreciation of .355, applicable to the assets used at this mine on May 1, 1917, which served the purpose of determining the value of the assets received in liquidation as at that date. It is clear, therefore, that the engineer in determining the factor to be used for depletion and depreciation purposes did not give consideration for any possible acquisitions in the future, and consequently there could not be included in the depreciation allowance, facilities acquired for war purposes during the amortization period. The amortization report discloses that amortization allowance was upon additional motors, machinery, switches, dwellings, and tipple construction acquired or installed subsequent to May 1, 1917.

OAKMONT MINE

In the case of the Oakmont mine, the deduction for depreciation was computed upon costs shown for 1918. The record also discloses that amortization was allowed on railroad siding and tipple construction, and a recomputation of depreciation after eliminating such amortizable assets results in a depreciation allowance of \$28,211.91, whereas the amount previously allowed was \$39,544.67, or a reduction of \$11,332.76.

Settlement of the case has been delayed due to a request of the taxpayer for an opportunity to prove that the amount of depreciation previously allowed was not excessive. There may be some merit to this contention since it does not appear that the bureau engineer made allowance for plant additions subsequent to March 1, 1913, in arriving at the factor 0.25061 as to the Diamond mine. However, there is some question whether the taxpayer intends to proceed with the proof of its case, so it is believed that the revised certificate should be issued. Correction can be later made if necessary through the issuance of a revised certificate.

The tax liability for the year under consideration has accordingly been recomputed, based on the unit's revised depreciation allowance as to the Oakmont mine, and the overassessment so indicated is \$72,625.33 instead of \$79,890.72 previously recommended. The revised certificate of overassessment, which will be credited against outstanding taxes for 1917, is being forwarded to claims control section.

C. M. CHAREST,
General Counsel; Bureau of Internal Revenue.

EXHIBIT 11

IN RE BERWIND-WHITE COAL MINING CO., PHILADELPHIA, PA.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,

November 16, 1927.

Mr. COMMISSIONER: Certificates of overassessment of corporation income and profits taxes have been prepared in favor of the above-named company for the years 1919, 1920, and 1921 in the amounts of \$296,518.20, \$199,926.99, and \$281,234.01, respectively.

The taxpayer originally filed a consolidated return for the years under review including therein the income and invested capital of its subsidiary companies. The New River & Pocahontas Consolidated Coal Co. likewise filed consolidated returns for each of the years 1919, 1920, and 1921 and included in its consolidated return the income and invested capital of its affiliated subsidiaries. In the present audit of the case the Berwind-White Coal Mining Co. with its affiliated companies, and the New River & Pocahontas Consolidated Coal Co. with its subsidiary companies, have been ruled affiliated in a single group and the tax liability computed on the consolidated income and consolidated invested capital of these companies. The inclusion in a single consolidated group of the two groups of companies which originally filed separate consolidated returns is the principal cause of the overassessments above indicated. In addition to the Berwind-White group and the New River group there have been included in the consolidated return in the present audit of the case the incomes and capitals of the Eureka Stores Co., New River & Pocahontas Stores Co., and Berwind Lumber Co. The inclusion of these latter companies does not materially affect the tax liability as their liability on a separate basis or on a consolidated basis is not materially different.

The effect of the consolidation of the two groups on tax liability is principally due to the proportionately large invested capital of the New River group which when combined with the invested capital of the Berwind-White group causes the excess profits tax credit to nearly equal the income subject to profits tax. Thus, while the Berwind-White group for the year 1919 had an income on the original return of \$2,749,125.11 and a statutory capital of \$22,046,960.57 it had a profits tax liability of \$196,473.65. The New River group with an income of \$683,417.41 had an invested capital of \$19,711,652.55 and an excess profits tax of but \$12,894.12. On a consolidated basis with the combined invested capital of approximately \$40,000,000 the excess profits tax on the income of the entire group is only \$53,015. Since the overassessment for 1919 is \$296,518.20 and the reduction in excess profits tax is \$312,147.17 the overassessment is principally due to the consolidation of the two groups. The effect of consolidation for the years 1919, 1920, and 1921, so far as combinations of capital and profits tax liabilities are concerned, is indicated in the following schedule:

	Item	Income	Invested capital	Total tax	Excess-profit tax
1919	Original return.....	4, 173, 298. 97	44, 769, 126. 22	706, 775. 15	365, 116. 16
	Present audit.....	3, 981, 797. 81	46, 424, 410. 57	410, 256. 95	52, 968. 99
	Difference.....	191, 501. 16	1, 655, 284. 35	296, 518. 20	312, 147. 17
1920	Original return.....	6, 670, 725. 90	45, 832, 322. 44	1, 244, 591. 28	697, 371. 36
	Present audit.....	6, 258, 843. 70	46, 446, 873. 38	1, 044, 664. 29	508, 018. 77
	Difference.....	421, 882. 20	614, 550. 94	199, 926. 99	189, 352. 59
1921	Original return.....	3, 691, 598. 97	148, 620, 783. 79	617, 005. 11	331, 310. 88
	Present audit.....	3, 704, 139. 70	49, 630, 783. 79	335, 771. 10	None.
	Difference.....	12, 540. 73	1, 000, 000. 00	281, 234. 01	331, 310. 88

¹ Estimated (capital not computed on some returns as credit exceeded income).

The stockholdings in the companies comprising the present affiliated group are as follows:

	New River & Pocahontas Consolidated Coal Co.	Berwind- White Coal Mining Co.	Wilmore Coal Co.	Berwind Lumber Co.	Eureka Stores	New River & Pocahontas Stores
	<i>Per cent</i>	<i>Per cent</i>	<i>Per cent</i>	<i>Per cent</i>	<i>Per cent</i>	<i>Per cent</i>
E. J. Berwind.....	92.83	69.8	92.49	80.38	53.45	75.95
J. E. Berwind.....	2.51	12.6	4.41	1.87	14.09	7.28
H. A. Berwind.....	3.41	12.6	.28	9.24	16.25	8.40
E. J. Berwind, 2d.....	.10	-----	-----	.05	-----	-----
C. E. Dunlap.....	.20	-----	-----	.10	-----	-----
Thomas Fisher.....	.95	5.0	1.76	8.22	16.21	8.37
Robert I. Jenks.....	-----	-----	.88	.12	-----	-----
Mrs. W. A. Crist.....	-----	-----	.18	.02	-----	-----

E. J. Berwind, J. E. Berwind, and H. A. Berwind are brothers. E. J. Berwind, 2d, and C. E. Dunlap are nephews of E. J. Berwind. Thomas Fisher is an old employee and business associate of E. J. Berwind. Robert I. Jenks is an employee. Mrs. W. A. Crist is the wife of an employee.

The Berwind Lumber Co. was formed by E. J. Berwind for the purpose of cutting the timber from the lands of the New River & Pocahontas Consolidated Coal Co. He originally owned 100 per cent of the stock of said company. The shares which he sold or gave to the other stockholders were sold or given with the understanding (apparently an oral one) that he was to continue the control of the company; that the other stockholders were to vote the shares as he wished and that he was to have the right at any time to repurchase any of said shares. The New River & Pocahontas Consolidated Coal Co. and the Berwind Lumber Co., together with five other companies that appear to have been affiliated by the unit with the New River & Pocahontas Consolidated Coal Co. were operated jointly and were controlled by the same persons in the same office. The stockholders' meetings of all the companies were held jointly at the same time and place, and proxies of the stockholders of all the six companies were held and voted by E. J. Berwind's personal representative. There was one general office for the transaction of the executive work of all the companies and for the keeping of the records and accounts thereof. The expenses of that office were allocated among the companies in accordance with Mr. Berwind's directions. The funds of one company have been placed at the disposal of another in emergencies, either without interest or at normal rates and without any corporate action.

In addition to the foregoing the Berwind-White Co. has expended in the development of properties of the Wilmore Coal Co. (which company is clearly affiliated with the New River & Pocahontas Consolidated Coal Co.) including the installation of mining equipment and the erection of miners dwellings and other structures a total of more than \$10,000,000. The Berwind-White Co. has no written agreement or means of safeguarding its investment in the Wilmore Coal Co.'s properties and could be divested of any participation in the permanent benefits secured to the Wilmore Coal Co. if it were not for the practical unity and common ownership of all of the corporations.

Affidavits have been filed by E. J. Berwind, H. A. Berwind, Thomas Fisher, and E. J. Berwind, 2d, stating that while E. J. Berwind has entrusted the management of the Berwind White Coal Mining Co. to their care every important question affecting the policy of any of the companies is fully discussed with E. J. Berwind in advance of any determinative action in respect thereto and that Mr. E. J. Berwind's decision of every question is final. Based upon the above facts and other information in the file the Income Tax Unit has found that all of the companies operated substantially as a unit and that all of the stock of all of the companies is owned or controlled by the same interests within the meaning of Section 240 of the Revenue Act of 1918. In view of the foregoing it is believed that the inclusion of the New River & Pocahontas Consolidated Coal Co. and its subsidiaries, the Berwind White Coal Mining Co. and its subsidiaries, the Wilmore Coal Co., the Berwind Lumber Co., Eureka Stores and New River & Pocahontas Stores Co. in a single consolidated group is in accordance with the provisions of Section 240 of the Revenue Act of 1918.

The income shown by the returns filed for the year 1919 amounted to \$4,173,-298.97. This income has been reduced in the present audit of the case to \$3,981,-797.81. The net reduction in income is due to adjustments based upon a field investigation by which deductions claimed in the original returns were disallowed in the amounts of \$2,834.95 for insurance, \$412 for donations, capital items restored in the amount of \$69.55 and items pertaining to other years in the amount of \$198.06, amortization of leasehold in the amount of \$4,216.67 and deduction for amortization of the cost of war facilities in the amount of \$26,864.93. The disallowance of the deduction for amortization of the cost of war facilities is in accordance with the finding of the valuation engineers of the Income Tax Unit and the amount allowed as a deduction represents the actual loss computed in accordance with the provisions of Section 234 (a) (8) of the Revenue Act of 1918. The taxpayer has acquiesced in the foregoing additions to income. In addition to the above, income of the Eureka Casualty Co., an affiliated subsidiary in the amount of \$28,609.03 has been included in the consolidated income.

The income for the year 1919 as above increased has been reduced by the allowance of additional depreciation in the amount of \$63,706.66, depletion in the amount of \$123,435.77, excessive income on Navy coal, \$47,698.34 and repairs not claimed on the original return in the amount of \$15,810.69. A further adjustment has also been made to bring several of the subsidiary companies' returns to a calendar year basis by which the consolidated income has been reduced to \$4,094.93. The allowance of the additional depreciation and depletion deductions is based upon a field investigation and the recommendation of the engineers of the Income Tax Unit. The present allowance represents the actual loss sustained by the taxpayer in this connection during the year 1919.

During the years 1919, 1920, and 1921, shipments of coal consigned to the taxpayer's regular commercial customers were seized by the Navy Department. The taxpayer included in sales the billed price of the coal so seized by the Government. Pursuant to the contract of purchase offered by the Navy Department the taxpayer accepted 75 per cent of the price fixed in the contract and received immediate payment to that extent. Suit was brought in accordance with the provisions of the contract for the difference between the amount received and an amount which would constitute compensation for the property seized. Settlement under the suit was finally adopted by way of compromise in 1926. The reduction in income allowed in the present audit of the case is the difference between the billed price of the coal included in the taxpayer's gross income and the actual cash received by the taxpayer from the Government in 1919. Since the balance which the taxpayer might receive could not be determined with any degree of certainty it could not therefore be accrued. The reduction of income to the amount actually received appears proper.

The foregoing adjustments to income result in the reduced income shown in the present audit of the case. The overassessment above stated is principally due to the consolidation of the two groups and not to this reduction in income. For the reasons above stated the affiliation appears proper, and it is recommended that the overassessment for the year 1919 be allowed.

The income reported on the returns for the year 1920 was \$6,670,725.90 and the income indicated in the present audit of the case is \$6,258,843.70. This reduction in income is due to adjustments made as a result of the field investigation by which the income shown on the original returns has been increased by the disallowance of deductions claimed for donation in the amount of \$3,452.64, amortization of leasehold, \$4,216.67, depletion in the amount of \$59,744.37 and an adjustment to change a subsidiary company from a fiscal to a calendar year basis in the amount of \$9,726.11. The taxpayer has acquiesced in the foregoing additions to income.

The income for the year 1920 as above increased has been reduced by the allowance of additional depreciation of \$64,309.32, excessive income on Navy coal of \$284,547.75, loss on power houses of \$139,545.70, income tax of \$471.76, and items pertaining to other years of \$178.06. The additional deduction allowed for depreciation is based upon the recommendation of the engineers of the income-tax unit and the present allowance represents the actual loss sustained by the taxpayer in this connection. The loss on the power house is in connection with the abandonment of a steam plant during the year 1920. The present allowance is the depreciated book value less the scrap value of the steam plants abandoned in the general electrification of the taxpayer's mines. The income-tax unit has verified by field examination the fact that the plants were abandoned and has subjected the book value and scrap value to careful review. The reduction in income in connection with the Navy coal is the same type of adjustment as was made for the year 1919 and reduces the amount originally reported by the

taxpayer in gross sales from the billed price to the amount of cash accepted by the taxpayer from the Navy Department during the year 1920. The foregoing adjustments to income result in the reduced income used in the present audit of the case. The overassessment, however, as previously stated, is principally due to the consolidation of the New River and Berwind White groups, which eliminates a large part of the excess-profits tax indicated on the original return.

For the year 1921 the income reported on the original return was \$3,718,310.70 and the income shown in the present audit of the case is \$3,704,139.70. This reduction in income is principally due to a revision of the deductions claimed on the taxpayer's return for depreciation and depletion and to the allowance of a reduction in income for the excessive amount reported on Navy coal. The overassessment in the year 1921 is practically entirely due to the consolidation of the two groups as there was an excess-profits tax on the original return of \$331,310.88 and there is no excess-profits tax under the present audit.

In view of the foregoing it is recommended that the overassessments be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved:

D. H. BLAIR,
Commissioner of Internal Revenue.

EXHIBIT 12

FEBRUARY 1, 1928.

Mr. E. C. ALVORD,
*Special Assistant to the Secretary of the Treasury,
Walker-Johnson Building, Washington, D. C.*

MY DEAR MR. ALVORD: In regard to the refund proposed to the Berwind White Coal Mining Co. for the years 1919 to 1921, inclusive, as shown on Schedule No. 27853, I would appreciate an answer to the following questions by your general counsel's office:

No. 1. The amortization allowance for 1918 and 1919 was based on the proposition that the old electrical plants and the new electrical plant of the company were all in 52.6 per cent use. In 1920, loss of useful value on the old plant is allowed which write it down nearly to salvage value. This means that the new plant goes back into practically 100 per cent use. Why, in view of this fact, should not the amount allowed as amortization on the new plant based on a 52.6 per cent use, be reported as income in 1920?

No. 2. The revenue agent's report which appears to have been accepted shows a loss of useful value on certain items of the old plant which are still retained in approximately 50 per cent use. Under what authority is a loss of useful value allowed before the items upon which such loss is claimed are *permanently discarded or abandoned*?

No. 3. The taxpayer consents to a deduction from the refund allowable in 1919, 1920, and 1921 of the amount of \$252,105.62 previously refunded to the taxpayer in cash for the year 1918, in spite of the fact that the statute of limitations has run on the year 1918. It appears that the 1918 tax should have been much larger than finally determined, the principal reason for this being the allowance of a loss on the sale of the stock of a subsidiary not allowable as a deduction under the H. S. Crocker & Co. decision. But the Crocker decision has not even been acquiesced in by the commissioner and it is conceded among experts that it is extremely doubtful if the courts will sustain the Board of Tax Appeals in the Crocker case. What does the bureau concede to the taxpayer in 1919 to 1921, in consideration for the \$252,105.62 voluntarily given up by the taxpayer on a doubtful point of law?

EXPLANATORY STATEMENT

In order to clarify the three questions submitted above, a few explanatory and descriptive remarks will be added on each question.

IN RE QUESTION NO. 1

On the 1st of January, 1918, the taxpayer had three separate and distinct power plants located in three separate power houses with a combined capacity of 9,000 kilowatts. The plants were designated as follows:

Power house:		Capacity
No. 36, built in 1904.....	kilowatts.....	1, 800
No. 40, built in 1906.....	do.....	1, 700
No. 35, built in 1909.....	do.....	5, 500
Total.....		do..... 9, 000

In June, 1918, the taxpayer began the construction of a new power plant having a capacity of 10,000 kilowatts. The total cost of this new plant was \$825,722.44, on which amortization appears to have been allowed for 1918 and 1919 amounting to \$373,401.12.

The allowance for amortization was based on the proposition that the old and new plants would be retained in use. As these plants had a combined capacity of 19,000 kilowatts and but 10,000 kilowatts were necessary, it was held that the combined plant was $\frac{10,000}{19,000}$ in use, or 52.6 per cent. This was the basis of the amortization as determined.

It appears to the writer that it has been a well-established principle that when a deduction from income has been taken in good faith and when later it is proven that the deduction was not correct in light of subsequent events, then such deductions shall be reported as income when such fact becomes apparent. For instance:

(a) A bad debt is charged off in 1920 in good faith and with proper proof. However, in 1921 the debt is unexpectedly paid. The practice of the bureau, as we understand it, is to cause this payment to be reported as income in 1921.

(b) An item is permanently abandoned and dismantled in 1920 and a certain amount written off for loss of useful value. Due to unexpected conditions the item is reconditioned and put back in service in 1926. It appears that the practice of the bureau is to require the report of the useful value charged off in 1920 as income in 1926.

(c) Regulations 45 distinctly require the taxpayer to report items amortized to scrap or salvage value to be reported if returned to use. The obvious purpose of this is to require the inclusion in income of the amortization previously allowed.

The writer is of the opinion that the same principle is involved in the case of partial use.

If in this case we assume that the amortization claim of the taxpayer is in good faith and that he was properly allowed \$373,000 in amortization for 1918 and 1919 on the basis that the new plant was only 52.6 per cent in use then it would appear evident that, when he abandons his old plant in 1920 which returns the new plant to 100 per cent use, he should in that year return \$373,000 as income.

IN RE QUESTION NO. 2

The revenue agent's report contains the following tabulation:

Purchase date	Description	Cost	Depreciation per books to Apr. 1, 1920	Book value at Apr. 1, 1920	Salvage (50 per cent use)	Net loss
1909.....	Boiler house.....	\$30,796.00	\$17,066.12	\$13,729.88	\$6,864.94	\$6,864.94
Do.....	Two feed water heaters.....	3,886.00	1,764.90	2,101.10	1,060.55	1,060.55
Do.....	Lighting fire apparatus.....	1,556.00	862.28	693.72	300.00	393.72
1913.....	Four 591-horsepower Stirling boilers.....	21,000.00	7,437.50	13,562.50	6,781.25	6,781.25
Do.....	Sixteen Jones stokers.....	11,300.00	4,002.08	7,297.92	3,648.96	3,648.96
1909.....	Draft fan drive and engine.....	2,100.00	1,163.75	936.25	468.12	468.13
Do.....	Coal and ash handling equipment.....	19,185.00	10,631.69	8,553.31	4,276.65	4,276.66
1909-13.....	Breeching draft pipes.....	6,625.00	3,008.85	3,616.15	1,808.08	1,808.07
Do.....	Steam piping.....	4,500.00	2,043.75	2,456.25	1,228.12	1,228.13
Do.....	Feed water regulators.....	2,140.00	971.92	1,168.08	584.04	584.04
1909.....	Lighting and miscellaneous.....	500.00	277.08	222.92	111.46	111.46
1908.....	Wiring, lighting, oil department.....	2,617.00	1,581.10	1,035.90	517.95	517.95
Total.....		106,205.00	50,811.02	55,393.98	27,287.55	28,106.43

¹ Used.

² 15 per cent used.

It appears from the above that loss of useful value is allowed in the case of articles retained in partial use. Article 143 of Regulations 45, however, states as follows:

"Loss of useful value: When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189."

We would like to be advised as to the ruling under which loss of useful value is allowed in 1920 on items retained in partial use and not *permanently* abandoned.

IN RE QUESTION NO. 3

No additional comments to the question already stated appear necessary.

The date of payment in this case is February 10th and it is not desired to go into a detailed review of the case which will delay final settlement. The writer would, however, appreciate being advised on the questions raised in this letter. If the points made are not plain, I will be glad to confer with your representative.

Very truly yours,

L. H. PARKER.

EXHIBIT 13

IN RE BERWIND-WHITE COAL MINING CO., PHILADELPHIA, PA.

JANUARY 25, 1928.

Mr. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

MY DEAR MR. PARKER: Pursuant to your written instructions, I have made an examination of the proposed refund to the above named taxpayer, in the amount of \$777,679.20, as shown in memorandum of the office of general counsel addressed to the commissioner on November 16, 1927.

FINDING OF FACTS

The above named taxpayer's case was audited for the year 1918 in 1924, resulting in an overassessment of \$403,435.60. The refund was due to two reasons: First, allowance of amortization on war facilities in the amount of \$737,883.44; second, loss on sale of subsidiary company's stock (Maryland Coal Co.), \$396,625.00. The refund was disposed of as follows:

Credit against 1919 taxes	\$151, 329. 98
Actual refund	252, 105. 62

It has now been determined that the loss of \$396,625 previously allowed on the Maryland Coal Co.'s stock is not an allowable deduction under the principle laid down by the Board of Tax Appeals in the case of H. S. Crocker & Co. It has been further held that the Berwind-White Coal Mining Co., is affiliated with the New River & Pocahontas Consolidated Coal Co.

The result of these adjustments produces an additional tax for the year 1918 of \$737,485.74, which, due to the fact that the statute of limitations has expired

and no waiver has been filed, the bureau is without authority to assess. In other words, the refund previously made on this case was not only erroneous, but the taxpayer should have paid an additional tax of approximately \$500,000, against which the statute of limitations has run. It should be noted that the adjustment mentioned above does not take into consideration the question of whether or not the amortization has been properly determined in this case.

For the year 1919, in addition to the consolidation mentioned above, allowance has been made for a loss of useful value, in the amount of \$139,545.70. This loss has been based upon the difference between the depreciated book value of power houses and equipment, and, in some cases, the scrap value; in other cases, the sale value; and, in still other cases, value in use. The amortization is the amount recommended in the report of Engineer J. W. Swaren, dated October 21, 1922, and is on cost, as shown by the revenue agent's report, accrued in the calendar year 1919. The refunds for the years 1920 and 1921 are due primarily to the consolidation of the groups as mentioned above.

OPINION

1918 tax outlawed, \$737,485.74.—The bureau has reversed the credit of \$151,-329.90 previously allowed against 1919 taxes and now proposes to determine the amount of overassessment for 1919 without respect to this credit. This action appears proper and has apparently been considered by a member of the office of general counsel. The bureau further has secured from the taxpayer, in effect, a return of the amount of refund previously paid to it in the year 1923, referred to above. The action of the bureau is based upon the action of the board of directors of the Berwind-White Coal Mining Co., as evidenced by the following copy of directors' resolution:

[The Berwind-White Coal Mining Co., Miners and Shippers of the Eureka Bituminous Coals. Commercial Trust Building, Philadelphia]

CERTIFICATE OF DIRECTORS' RESOLUTION, THE BERWIND-WHITE COAL MINING CO., PHILADELPHIA, PA.

I, Wm. W. Wharton, secretary of the Berwind-White Coal Mining Co., a corporation duly organized, existing and doing business under and by virtue of the laws of the State of Pennsylvania, hereby certify that the following resolution was unanimously adopted by the board of directors of said corporation at a special meeting duly called for the purpose and duly held at the company's general office in Philadelphia, at 12 o'clock noon on Thursday, December 1, 1927:

On motion, duly seconded, it was unanimously

"Resolved, That this company consent, and it does hereby consent and agree, that the amount of a cash refund of 1918 Federal income and profits taxes heretofore recovered in the principal sum of \$252,105.62, together with interest thereon from the date of its payment to the company, on or about June 3, 1924, to the effective date of the offset thereof hereby authorized, may be credited against offset and applied to reduce the gross amount of any Federal income and/or profits taxes now found to be refundable and which shall be refunded to this company, as of the taxable years 1919, 1920, and/or 1921, in a net amount, including interest but excluding the aforesaid deduction, of not less than \$540,000."

In testimony whereof I have hereunto subscribed my name, in my aforesaid capacity, and hereto affixed the seal of the aforesaid corporation, at my office in Philadelphia, this 2d day of December, 1927.

[SEAL.]

WM. W. WHARTON, *Secretary.*

Loss of useful value allowed in 1919, \$139,545.70.—Two questions arose in the review of this item: First, whether or not there was a basis for loss of useful value on certain items; and second, whether proper depreciation had been accrued on the items which are involved in the claim. Mr. E. L. Seroggin, the auditor in the case, and Mr. Volney Eaton, the reviewer, were both consulted with respect to the revenue agent's recommendation. The legal basis for this allowance apparently is article 143 of Regulations 45. This article reads as follows:

"Loss of useful value: When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other

disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189."

It is obvious, from the wording of the above-quoted article, that buildings are subject to a loss of useful value only when they are *permanently* abandoned or *permanently* devoted to a radically different use, and machinery only when its use as such is *permanently* abandoned. Certain items coming within this claim have been abandoned apparently or sold, for the reason that sale or scrap value is shown in the revenue agent's report. The following items appear not to have been abandoned, but to have been retained for occasional use. The record submitted herewith is a transcript of those items as they appeared in the revenue agent's report. The auditor and reviewer both explained that they merely accepted the report without looking into this matter, and were, therefore, unable to say whether or not the items were retained in use. It seems clear, from the wording of the revenue agent's report, that items were retained for occasional use, and, under the provisions of the above-quoted article, loss of useful value is clearly not allowable on these items if the facts are as they appear to be: (See Exhibit A.)

Depreciation accrued.—In arriving at the deductible loss mentioned above, the revenue agent apparently has proceeded on the assumption that the loss is the difference between the depreciated book value of the items as they appear on the taxpayer's books and the scrap or sale value. There are not sufficient facts available to determine whether or not depreciation was set up yearly on these items from the date of their acquisition. Many of them were purchased as far back as 1904. The taxpayer has laid claim to rates of depreciation as follows:

Electrical equipment.....	per cent..	15
Buildings.....	do.....	5
Steam and boiler equipment.....	do.....	10

and inasmuch as these rates are used in the postwar years under audit, it is assumed that they are normal rates to be applied. Applying these rates to the property involved in the claim for loss of useful value, a substantial portion of the recommendation mentioned above would be eliminated. The regulations with respect to this question are plain. Article 143, quoted above, which is the authority for adjusting depreciation, provides that the amount shall be the "depreciation sustained." The fact that the taxpayer's books contained certain depreciated values is not evidence of the depreciation sustained in prior years, especially in view of the fact that rates are claimed during the period under audit of such that if applied to prior years would result in a substantial increase in depreciation over that shown on the books.

Amortization allowed, \$40,101.17.—The amount of amortization allowed for the years 1918 and 1919 was determined on October 31, 1922. The principles adopted at that time with respect to value in use have been substantially changed since that date by board rulings. The case does not show whether or not the bureau has examined this case with respect to current rulings before making the recommendation for the year 1919. Other cases coming before the committee appear to have been examined in the light of current rulings, and inasmuch as the deduction here is a substantial amount, it would appear that this case should have been likewise examined with that purpose in view.

Very respectfully,

G. D. CHESTEEN, Corporation Auditor.

Exhibit A

Purchase date	Description	Cost	Depreciation per books Apr. 1, 1920	Book value at Apr. 1, 1920	Salvage (50 per cent use)	Net loss
1909	Boiler house.....	\$30,796.00	\$17,066.12	\$13,729.88	\$6,864.94	\$6,864.94
1909	2 feed water heaters.....	3,886.00	1,764.90	2,101.10	1,060.55	1,060.55
1909	Lighting fire apparatus.....	1,556.00	862.28	693.72	1 300.00	393.72
1913	Four 591-horsepower Stirling boilers.....	21,000.00	7,437.50	13,562.50	6,781.25	6,781.25
1913	16 Jones stokers.....	11,300.00	4,002.08	7,297.92	3,648.96	3,648.96
1909	Draft fan drive and engine.....	2,100.00	1,163.75	936.25	468.12	468.13
1909	Coal and ash handling equipment.....	19,185.00	10,631.69	8,553.31	4,276.65	4,276.66
1909-1913	Breeching draft pipes.....	6,625.00	3,008.85	3,616.15	1,808.08	1,808.07
1909-1913	Steam piping.....	4,500.00	2,043.75	2,456.25	1,228.12	1,228.13
1909-1913	Feed-water regulators.....	2,140.00	971.92	1,168.08	584.04	584.04
1909	Lighting and miscellaneous.....	500.00	277.08	222.92	111.46	111.46
1908	Wiring, lighting, oil department..	2,617.00	-1,581.10	1,035.90	2 155.38	880.52
	Total.....	106,205.00	50,811.02	55,373.98	27,287.55	28,106.43

¹ Used.² 15 per cent used.

EXHIBIT 14

IN RE BERWIND-WHITE COAL MINING CO., PHILADELPHIA, PA.

FEBRUARY 16, 1928.

Mr. E. C. ALVORD,

Special Assistant to the Secretary of the Treasury:

Reference is made to the attached memorandum dated February 1, 1928, addressed to you by Mr. L. H. Parker, chief of division of investigation, for the Joint Congressional Committee on Internal Revenue Taxation, which you have referred to me for consideration. The memorandum requests an answer to three questions.

The first question asked is in connection with the allowance of a deduction for amortization for the years 1918 and 1919. It appears that a deduction was allowed in the amount of \$333,299.95 for 1918 and \$40,101.17 for the year 1919, a total allowance of \$373,401.12. This office is requested to explain why, if the plant on which the amortization was allowed is used 100 per cent in 1920, there should not be restored to taxable income in 1920 the amount allowed as a write-off for amortization in 1918 and 1919.

Either the plant was actually used to 100 per cent of capacity in the postwar years and amortization should be disallowed in 1918 or the plant was only in operation to the extent of 52.06 per cent of capacity and amortization was properly allowed in 1918. Under the provisions of article 184, Regulations 45 and 62, the amount of amortization is determined by a comparison of the facilities during the amortization period with their condition during the postwar period. The use to the extent of 100 per cent in 1920 has no bearing at all on the allowance of amortization as the postwar period—the test period for the determination of value in use—does not begin until 1921. In view of this fact, the percentage of use in 1920 becomes wholly immaterial as, e. g., the plant might have been used to capacity in 1920 and during the entire postwar period of 1921 to 1924 used only to the extent of 10 per cent of capacity. Under these circumstances it would be very difficult to conceive that amortization should be allowed for 1918 as a deduction, restored to income for 1920 and then again allowed as a deduction in view of the postwar experience. The actual extent of the employment of the facility in 1920 would have no bearing on the allowance of amortization and the allowance of amortization would not warrant throwing the amount of the deduction in the taxable income for the year 1920 in the event the facility is employed to the extent of 100 per cent in 1920. This office can, therefore, see no reason why the amount allowed as a deduction for amortization in 1918 should be restored to income in the year 1920.

The inquiry is also made of this office as to the authority under which a loss in useful value is allowed in 1920 on the taxpayer's power plant which had not been permanently discarded or abandoned, but was still retained to the extent of

approximately 50 per cent in use. From a review of the records in this office it is believed that there is a misapprehension as to the facts in this case caused by the terms employed in the revenue agent's report. It is noted, in the schedule copied from the revenue agent's report in the memorandum addressed to you, that the allowance for loss in useful value equals the difference between the book value at April 1, 1920, and salvage (50 per cent use) value. It is the understanding of this office from statements made by the field agent in the Income Tax Unit that the assets in question constituted a power plant; that the power plant was practically abandoned through tearing out of steam lines, etc., and that the taxpayer operated its properties from April, 1920, through the employment of the new electric-power facilities completed about that time. The bureau examiners, to be conservative and protect the interests of the Government as far as possible, held that the loss on facilities was limited by a large salvage value due to the condition of the particular items. A 50 per cent salvage value was determined in connection with these facilities. This determination of a high salvage value does not amount to a finding that the asset was in active use and does not preclude the allowance of a deduction for a loss in useful value of an asset actually discarded as far as operations are concerned. In view of the facts as understood by this office, the allowance of the deduction for loss of useful value is entirely in accordance with the provisions of article 143, Regulations 45.

The third question seems to proceed upon the assumption that through the application of the decision in the case of *H. S. Crocker Co.*, 5 B. T. A. 537, there is being offset against the overassessments an erroneous refund previously made to the taxpayer for 1918. As will be seen from the following, the Crocker decision has at the most a very remote bearing on the matter.

In the first instance there was found an additional tax liability of approximately \$450,000 due to affiliation of the Berwind-White Coal Co. group and the New River & Pocahontas Consolidated Coal Co. group. The question of affiliation was given consideration in January, 1924, and it was found under the rulings as they then existed that the companies had not been properly affiliated. The companies were accordingly ruled not affiliated, and on this basis it was found that there had been an overpayment of tax.

Later, the matter of affiliation was again considered in connection with the audit for the years 1919, 1920, and 1921. In the meantime, the Board of Tax Appeals had handed down a number of decisions on the question of affiliation and it was found that under these decisions the present companies were properly affiliated. As a result of this ruling it was found that \$252,105.62 had been previously refunded in error for the year 1918. The taxpayer's representative was notified that it was the intention of this office to recommend to the Comptroller General of the United States that the refund for later years be withheld and that suit be instituted in accordance with the provisions of the act of Congress approved March 3, 1875 (18 Stats. 481) for the collection of the tax refunded through error of law. Upon being convinced of the merits of the position of this office and in view of the decision in the cases of *Standard Spring Manufacturing Co.* (U. S. D. C. Minn., Oct. 15, 1927) and *Talcott v. U. S.* (21 Fed. 2d 493) the taxpayer consented to the crediting of the amount of tax erroneously refunded for 1918 against the present certificates of overassessment for the later years. There was no suggestion at any time in any of the conferences leading up to this settlement of the case of a concession in regard to later years being made in consideration of the taxpayer's repayment of the 1918 tax.

During the consideration of the case it was noted that if the board's decision in the Crocker case and particularly its decision in the *Farmers Deposit National Bank case*, 5 B. T. A. 520, were applied there would be a further additional tax liability for the year 1918 but this outlawed tax did not figure into the settlement of the matter.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

EXHIBIT 14(A)

IN RE BERWIND-WHITE COAL MINING CO.

TREASURY DEPARTMENT,
Washington, June 11, 1929.

MR. L. H. PARKER,
Chief, Division of Investigation,
Joint Committee on Internal Revenue Taxation,
House Office Building, Washington, D. C.

DEAR MR. PARKER: It is noted that the report to you in the above-named case submitted by Mr. Chesteen under date of January 25, 1928, raises a question as to the depreciation item in the computation of loss on the abandoned assets as well as the other matters made the subject of the memorandum included in the staff report to the joint committee as Exhibits 12 and 14.

The field examiner of the bureau recommended for approval the allowance of a loss in connection with discarded power facilities to the extent of 50 per cent of their book value at date of discardation. The field examiner, after a survey of the property, held that due to their high state of preservation, a salvage value of 50 per cent of the book value existed and consequently the loss in useful value was limited to 50 per cent of the book value.

The suggestion is made by Mr. Chesteen that if the rates of depreciation allowed in the current years are applied from the date of acquisition of the assets, the total sustained depreciation on this basis would exceed the book depreciation reserve used by the field examiner in computing the book value of the assets. As a mathematical proposition this is true, but it is also noted that replacements and renewals are generally charged to the depreciation reserve, so that from an accounting standpoint the book reserve as reduced by these charges correctly measures the proportion of the original cost less salvage value which the period from the acquisition to date bears to the total estimated useful life of the properties.

The bureau and the office of the general counsel accepted the field examiner's verification of this accounting phase of the computation of loss in useful value allowed as a deduction. The principle involved is one of general use and the amount of the loss, \$28,106.43, is small when compared to the corrected taxable income of approximately \$4,000,000.

Other points involved in the case are fully discussed in the prior reply of the bureau. (See Exhibit 14.)

In view of all the facts it is the opinion of the bureau that the loss itself has been properly computed.

Very truly yours,

E. C. ALVORD,
Special Assistant to the Secretary of the Treasury,

EXHIBIT 15

IN RE UTAH COPPER COMPANY, 25 BROAD STREET, NEW YORK, N. Y.

OFFICE OF THE GENERAL COUNSEL OF INTERNAL REVENUE,
February 23, 1928.

MR. COMMISSIONER: A certificate of overassessment has been prepared in favor of the above-named corporation for the calendar year 1917 in the amount of \$73,762.49.

The overassessment is due to adjusting the tax liability under section 304(c) of the revenue act of 1921.

The taxpayer filed the usual income and excess profits tax returns, for the calendar year 1917 which were duly audited and the tax liability was adjusted accordingly. On March 23, 1923, after the passage of the revenue act of 1921 the taxpayer filed claim for refund based upon the provisions of section 304(c) of said act, which provides as follows:

"In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title or any tax imposed by Title II of the revenue act of 1917, and the tax on the remaining portion of the net income shall be the same proportion of a tax computed without the benefit of this subdivision, which such remaining portion of the net income bears to the entire net income."

Consideration of the case in connection with the claim for refund discloses that the total income subject to excess profits tax is \$21,540,703.11 and that the net income derived from gold mining was \$448,193.27, after deducting a proportionate part of the general expenses. On this basis the percentage of net income from the gold is 2.0807 and the decrease in tax liability is \$73,762.49.

The overassessment is allowable under the provisions of section 284(b) of the revenue act of 1926, the taxpayer having filed claim within four years from the payment of the tax.

It is, accordingly, recommended that the overassessment above indicated be allowed.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Approved February 25, 1928.

C. R. NASH,
Acting Commissioner of Internal Revenue.

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